80-1434

No. 80-

Office-Supreme Court, U.S.
FILED
FEB 23 1981
ALEXANDER L. STEVAS,
CLERK

In the

SUPREME COURT OF THE UNITED STATES

October Term 1980

MISSOURI-KANSAS-TEXAS RAILROAD COMPANY,

Petitioner,

v.

UNITED STATES OF AMERICA,
INTERSTATE COMMERCE COMMISSION and
BURLINGTON NORTHERN, INC.,

Respondents.

# PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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February 23, 1981

## QUESTIONS PRESENTED*

1. Where by statute the Interstate Commerce Commission may authorize a proposed rail merger only when it is consistent with

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* The parties to the consolidated Petitions for Review in the Court of Appeals were: Missouri-Kansas-Texas Railroad Company, Railway Labor Executives' Association, People of the State of Illinois, Illinois Commerce Commission, Patrick W. Simmons, M. S. Stuckey, Board of Trade of Kansas City, Missouri, Inc., Soo Line Railroad Company, petitioners, consolidated petitioners and intervening petitioners below; United States of America, Interstate Commerce Commission, Burlington Northern, Inc., St. Louis-San Francisco Railway Company, respondents and intervening respondents below.

Pursuant to Rule 28.1 Petitioner states that it is a corporation and is a subsidiary of Katy Industries, Inc., which owns 97.77% of the common stock of Petitioner. The following companies are subsidiaries of Petitioner, except wholly owned subsidiaries, with percentage owned indicated: Galveston, Houston & Henderson R.R. (50%); Joplin Union Depot Co. (33.33%); Kansas City Terminal Ry. Co. (8.33%); Terminal R.R. Association of St. Louis (6.25%); Texas City Terminal Ry. Co. (33.33%); Pullman Co. (1.04%); Trailer Train Co. (2.44%). Katy Industries, Inc., Petitioner's parent company, has the following subsidiaries, except wholly owned subsidiaries, with percentage owned indicated: Quality Foods Machinery, Inc. (93%); American Gage & Machine Co. (80%); Simpson Instruments Sales & Services, Inc. (80%).

the public interest and where by statute the Commission must consider, as part of determining consistency with the public interest, the effect of the merger on the adequacy of rail service, did the Court of Appeals err in affirming the Commission's authorization of a proposed merger on the basis that the Commission may first find, and therefore approve, a proposed merger as consistent with the public interest, and then treat as a separate and distinct question whether and to what extent, by reason of the impact of the merger on the adequacy of service by other railroads, the merger should be subject to conditions to protect such service?

2. Where the statute governing rail mergers employs standards of "public interest" and "adequacy" of transportation to the public, and the statute requires as a matter of policy the encouragement of sound economic conditions among carriers, did the

Court of Appeals err in approving what it found to be a new "essential" service standard for determining whether financially weak carriers not parties to the merger are to be protected against admittedly major adverse effects of the merger?

3. Where Petitioner presented substantial evidence that the merger would negatively affect its revenues so that it would be unable to continue to provide adequate service and the Commission found that Petitioner's revenues would be negatively affected to a major degree, did the Court of Appeals err in affirming the Commission's conclusion that Petitioner and its service required no protection when such conclusion was not based on substantial evidence of record?

4. Where the Interstate Commerce Commission announced rule changes without notice and after the close of the proceedings that made Petitioner

procedurally ineligible for relief in those proceedings notwithstanding the merits of its case, did the Court of Appeals err, in conflict with the standards annunciated by this Court and other Courts of Appeals, in finding Petitioner's due process rights had not been violated where there was no showing of any statutory need to justify the retroactive application of the new rules?

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# PETITION FOR A WRIT OF CERTIORARI

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Petitioner Missouri-Kansas-Texas Railroad ("Katy" or "MKT") respectfully petitions this Honorable Court for a Writ of Certiorari to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit which affirmed an Order of the Interstate Commerce Commission ("ICC" or "Commission") approving the merger of Burlington Northern, Inc. ("BN") and St. Louis-San Francisco Railway Company ("Frisco").

## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reported: Missouri-Kansas-Texas Railroad Co. v. United States, 632 F.2d 392 (5th Cir. 1980). It affirmed an Order of the Commission which is also reported: Burlington Northern, Inc.--Control and Merger--St. Louis-San Francisco Railway Co., 360 I.C.C. 784 (1980). Both opinions are included in the Appendix to this Petition.[1]

## JURISDICTION

The judgment and opinion of the United States Court of Appeals for the Fifth Circuit was entered on November 24, 1980 and this Petition is filed within 90 days

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1. The Appendix to this Petition is cited herein as A ___. The Court of Appeals opinion is at A 1 - A 85, bound together with this Petition; the Commission report and order is at A 86 - A 485, bound in a separate volume.

thereof. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

## STATUTES INVOLVED

**49 U.S.C. § 10101. Transportation policy.**

> (a) To ensure the development, coordination, and preservation of a transportation system that meets the transportation needs of the United States, including the United States Postal Service and national defense, it is the policy of the United States Government to provide for the impartial regulation of the modes of transportation subject to this subtitle, and in regulating those modes
>
> > (1) to recognize and preserve the inherent advantage of each mode of transportation;
> > (2) to promote safe, adequate, economical, and efficient transportation;
> > (3) to encourage sound economic conditions in transportation, including sound economic conditions among carriers;
> > (4) to encourage the establishment and maintenance of reasonable rates for transportation without unreasonable discrimination

or unfair or destructive competitive practices;

(5) to cooperate with each State and the officials of each State on transportation matters; and

(6) to encourage fair wages and working conditions in the transportation industry.

(b) This subtitle shall be administered and enforced to carry out the policy of this section.

**49 U.S.C. § 11344. Consolidation, Merger, and Acquisition of Control: General Procedure and Conditions of Approval.**

(a) The Interstate Commerce Commission may begin a proceeding to approve and authorize a transaction referred to in section 11343 of this title on application of the person seeking that authority. When an application is filed with the Commission, the Commission shall notify the chief executive officer of each State in which property of the carriers involved in the proposed transaction is located and shall notify those carriers. If a motor carrier providing transportation subject to the jurisdiction of the Commission under subchapter II of chapter 105 of this title is involved in the transaction, the Commission must notify the persons specified in section 10328(b) of this title. The Comission shall hold a public

hearing when a rail carrier providing transportation subject to the jurisdiction of the Commission under subchapter I of that chapter is involved in the transaction unless the Commission determines that a public hearing is not necessary in the public interest.

(b) In a proceeding under this section, the Commission shall consider at least the following:

(1) the effect of the proposed transaction on the adequacy of transportation to the public.

(2) the effect on the public interest of including, or failing to include, other rail carriers in the area involved in the proposed transaction.

(3) the total fixed charges that result from the proposed transaction.

(4) the interest of carrier employees affected by the proposed transaction.

(c) The Commission shall approve and authorize a transaction under this section when it finds the transaction is consistent with the public interest. The Commission may impose conditions governing the transaction. When the transaction contemplates a guaranty or assumption of payment of dividends or of fixed charges or will result in an increase of total fixed charges, the Commission may approve and authorize the transaction only if it finds that

> the guaranty, assumption, or increase is consistent with the public interest. When a rail carrier, or a person controlled by or affiliated with a rail carrier, is an applicant and the transaction involves a motor carrier, the Comission may approve and authorize the transaction only if it finds that the transaction is consistent with the public interest, will enable the rail carrier to use motor carrier transportation to public advantage in its operations, and will not unreasonably restrain competition. When a rail carrier is involved in the transaction, the Commission may require inclusion of other rail carriers located in the area involved in the transaction if they apply for inclusion and the Commission finds their inclusion to be consistent with the public interest.

## STATEMENT OF THE CASE

On April 17, 1980 the Commission issued a report and order authorizing the merger of BN and Frisco under 49 U.S.C. § 11344. Katy and others had protested the proposed merger before the Commission on the ground that the merger as proposed did not comply with the statutory prerequisite of being consistent with the public interest. Katy had asked

that the Commission disapprove the proposed merger on the basis that the economic impact of the merger on Katy through the diversion of certain rail traffic to the new merged system would leave Katy, a financially marginal carrier, so weak that it would be unable to continue to provide adequate rail service to those shippers and communities which would continue to depend on Katy after the merger (360 I.C.C. at 864, A 167). Under the Interstate Commerce Act, 49 U.S.C. § 10101 et seq., in determining whether a merger is consistent with the public interest the Commission must consider its effect on the adequacy of transportation service to the public generally, and not just the public to be served by the merging railroads. 49 U.S.C. § 10101, 49 U.S.C. § 11344.

Alternatively, Katy asked that the Commission use its statutory power to impose conditions on the merger so as to make it

consistent with the public interest. See 49 U.S.C. § 11344(c). Specifically Katy asked that it be indemnified by the merged company for any loss in net income resulting from the traffic diverted by the new company to itself from Katy (360 I.C.C. at 865, 872, A 168, A 175). This would have permitted Katy to be financially able to continue to provide adequate rail service to those communities and shippers that would continue to depend on Katy for rail service after the merger. Another condition that Katy could have asked for was inclusion in the merged system. However, the Commission had previously issued a policy statement that it would not grant inclusion in a rail merger if there were any reasonable alternative. Railroad Consolidation Procedures, 359 I.C.C. 195 (1978). Because, as Katy demonstrated, an indemnification formula could be devised that would permit it to be able to continue to provide adequate rail service,

it was ineligible for inclusion under the Commission's announced policy. Also, the Commission has the statutory power to impose any protective condition, whether or not proposed by any protesting party, and, as Katy was aware, the Commission had exercised this power in previous merger cases.[2]

After the close of the proceedings, in its report and order in the BN-Frisco case, the Commission announced two new policy determinations that, notwithstanding any finding as to the public interest of the merger or the need for protective conditions for Katy, made Katy procedurally ineligible for protective conditions. The Commission ruled that it would not impose indemnity under any circumstances (360 I.C.C. at 953, A 256), although it is clear the Commission

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2. See, e.g., United States v. ICC, 396 U.S. 491, 501 (1970) (Northern Lines Merger Cases). (See also 360 I.C.C. at 950, A 253).

has the statutory power to provide indemnity and it has previously done so; and the Commission further ruled that it would not impose any protective condition that had not been requested by the protesting party (360 I.C.C. at 951-52, A 254-55), although again, as above indicated, there is no such statutory limitation. Therefore Katy, notwithstanding the merits of its case and without prior notice, found itself, through the retroactive application of these rules, procedurally ineligible for any relief to which it was substantively and statutorally entitled in the public interest in order to assure the adequacy of its service.

The Commission approved the proposed merger without imposing protective conditions for Katy despite the Commission's findings that traffic diversions resulting from the merger would have a major negative impact on Katy's revenue (360 I.C.C. at 955, A 258). It first ruled that Katy's

requested relief--indemnity--could not be granted because of the Commissioner's new policy against granting indemnity under any circumstances (360 I.C.C. at 952-53, A 255-56). It then "additionally" found that despite the traffic diversions and loss of revenues, in view of Katy's future prospects, Katy's losses would not adversely impact its ability to provide "essential" services (360 I.C.C. at 954, A 257). This finding was based on judgments as to three factors, none of which judgments were supported by substantial evidence of record.[3] One Commissioner, dissenting, concluded that the impact of the admitted loss of revenue would adversely affect Katy's ability to

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3. The three factors were an alleged "potential" increase in coal traffic, a possible reduction in maintenance costs when Katy's rehabilitation program is completed, and a tax benefit agreement between Katy and its parent relating to the latter's reimbursement of Katy in respect of Katy's tax losses (360 I.C.C. at 954-55, A 257-58).

continue to provide essential service and believed that indemnity was a proper protective condition (360 I.C.C. at 963, A 266).

After the Commission issued its Report and Order authorizing the merger, Katy sought review in the United States Court of Appeals for the Fifth Circuit pursuant to 28 U.S.C. §§ 2321(a) & 2342(5). The Court of Appeals stayed the effectiveness of the order pending disposition of the petition for review and this Court denied BN and Frisco's application to vacate that stay. Burlington Northern, Inc. v. Missouri-Kansas-Texas Railroad Co., Docket No. A-1053, ___ U.S. ___, 48 U.S.L.W. 3820 (June 16, 1980). The Fifth Circuit vacated the stay and affirmed the Order of the Commission on November 21 and 24, 1980 respectively. On November 21, Justice Powell continued the stay pending further order and on November 26 the full Court vacated the stay and denied Katy's request

to stay the order and merger pending this Petition. Missouri-Kansas-Texas Railroad Co. v. United States, Docket No. A-453, ___ U.S. ___ (November 21, 1980), ___ U.S. ___ (November 26, 1980). The merger was immediately consummated.

The merger combines two financially strong carriers into a huge new system. BN, already the largest railroad in the country in miles operated and second largest in revenues (360 I.C.C. at 793, A 96), has operated primarily in the northwestern quadrant of the United States between Chicago and the Pacific coast extending south to Kansas City and St. Louis with a route into Texas through Denver via two subsidiaries, the Colorado and Southern (C&S), and the Fort Worth and Denver (FW&D) (360 I.C.C. at 794, A 97). Frisco, in addition to lines extending east of the Mississippi to Memphis, Birmingham and Pensacola, has operated south of Kansas City and St. Louis reaching points

in Kansas, Oklahoma and Texas as far south as Fort Worth and Dallas (360 I.C.C. at 799, A 102).

Katy is a 2200-mile line of railroad operating in the states of Missouri, Kansas, Oklahoma and Texas between Kansas City and St. Louis on the north and Dallas, Fort Worth, Houston and Galveston on the south (360 I.C.C. at 865, A 168). Thus, Katy has heretofore served as an important end-to-end connection of BN for traffic which BN originates or terminates in the upper Midwest (or handles as a bridge line to and from other railroads) and Katy terminates or originates in its territory (R400).[4] Katy also has handled traffic as a bridge or intermediate line between BN and other carriers, including BN's subsidiary FW&D.[5] Frisco, in

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4. References to the "Certified Copy of the Portions of the Record Relied Upon by the Parties in Their Briefs", filed in the Court of Appeals, are cited as R__.

5. BN's line to Texas through Denver is

this territory, has frequently been a direct competitor of Katy. By reason of the BN-Frisco merger, the Frisco line bridges the gap between BN at Kansas City and FW&D at Fort Worth and Dallas as part of a new single line system running between BN's vast operating territory north of Kansas City and the growing commercial areas of Texas as far south as Houston and Galveston (R18-R19). Thus BN, formerly an end-to-end connection of Katy with which it did not directly compete, has now become a direct competitor of Katy throughout much of Katy's operating territory.

Katy is the railroad most adversely affected by this merger (R551-R552) as confirmed in BN's testimony (R14). The evidence introduced by Katy shows that the

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obviously not a good competitive service route for BN's traffic between the upper Midwest and Chicago (where BN has connections to the East), on the one hand, and Texas, on the other hand (360 I.C.C. at 938, A 241).

impact on Katy's financial well-being is such that it cannot help but seriously impair Katy's ability to provide adequate rail service to those shippers and communities that will continue to rely on Katy for such service after the merger and diversions. Adequate service is dependent on the financial wherewithal to provide it (360 I.C.C. at 937, A 240) and Katy is in weak financial condition, with a long history of negative working capital (360 I.C.C. at 1118-24, A 421-427). Only four months before approving the BN-Frisco merger, the Commission found Katy to be in "very weak financial condition." Adequacy of Railroad Revenue, 362 I.C.C. 198, 324 (1979). The impairment of Katy's remaining service will thus result from the substantial diminution of its already limited funds available to maintain its roadway and related facilities and equipment, to make capital replacement or improvements through purchase of new

equipment or other property, or to repay outstanding indebtedness and the fixed charges thereon (R553). A danger of Katy's bankruptcy is created (R131).

That the merger would have a severe adverse impact on Katy is clear and undisputed; it was conceded by the merger applicants from the outset of the proceedings before the Commission and found by the Commission itself. Pursuant to the Commission's regulations, the applicants submitted evidence of the effects of their proposed merger on other railroads by making a study of their traffic for the year 1976. The applicants themselves estimated that they would divert to their own system a large volume of traffic heretofore moving via Katy, such traffic producing for Katy an estimated $6.5 million of gross revenues annually (R196). The Commission found that Katy would suffer an even greater loss of gross revenues to the merged system, based

on 1976 movements, ranging from $8,600,000 to $8,900,000 annually (360 I.C.C. at 1091, A 394).[6] The Commission found that when the full effect of the merger and diversions had taken place after three years this would mean a loss of $4,530,000 in annual net income to Katy[7] (360 I.C.C. at 1110,

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6. The loss consists of $6.5 to $6.8 million on traffic of Katy interchanged with the merger applicants and $2.1 million on traffic of Katy interchanged with other railroads.

7. The Commission's conclusion as to what amount of gross, and therefore of net, revenue which Katy would lose by reason of the merger was based on evidence of record which assumed that the so-called standard or DT&I traffic conditions for the protection of other roads would be imposed on the merged system as conditions to approval of the merger, without restriction as to time limit. This had been the Commission's unfailing custom for decades in major rail mergers and other unifications (See 360 I.C.C. at 933-34, A 236-37). However, the Commission here, after reaching its conclusions as to Katy's traffic and revenue losses based upon such evidence, determined that the DT&I conditions will be imposed for a period of only two years. There is no evidence of record whatever as to the effect of the lifting of the DT&I conditions after two years on the amount of the diversion of traffic and revenues beyond the amount found

A 413). In view of the fact that Katy's gross revenues for the study year amounted to only $101 million (360 I.C.C. at 1123, A 426), the Commission properly characterized Katy's loss as a "major loss of interline traffic and revenues" (360 I.C.C. at 955, A 258).

## ARGUMENT

### I

### THE COURT OF APPEALS ERRED IN AFFIRMING THE COMMISSION'S DECISION ON THE BASIS THAT THE COMMISSION COULD APPROVE THE PROPOSED MERGER AS CONSISTENT WITH THE PUBLIC INTEREST SEPARATELY FROM THE STATUTORILY REQUIRED CONSIDERATION OF EFFECT ON ADEQUACY OF RAIL SERVICE OF OTHER RAILROADS

The Court of Appeals made a basic error in its understanding of this case, the issues herein, the position of the parties

by the Commission, and the Commission does not even address this subject in its Report.

and the statutory prerequisites for merger approval when it stated that, "[n]one of the petitioners directly challenge the Commissioner's ultimate conclusion that the BN-Frisco merger is in the public interest." (632 F.2d at 399, A 24). This error tainted its entire analysis of the case. The Court of Appeals apparently thought that there were two issues: one, was the merger consistent with the public interest; and two, had an adequate showing been made for the imposition of conditions to protect the service of other railroads. However, this does not reflect the statutory scheme or the position of Katy before the Commission or the Court of Appeals.

A proposed rail merger is not consistent with the public interest if the continuation of other adequate rail service is harmed thereby. 49 U.S.C. § 10101, 49 U.S.C. § 11344. Soo Line R.R. v. United States, 271 F. Supp. 869, 873 & n.1 (D. Minn.

1967). Katy presented evidence before the Commission that the merger, by causing diversion of traffic from Katy to the merged railroad, would decrease Katy's revenue and income to the point where Katy would be unable to continue to provide adequate rail service to those shippers and communities who would continue to rely on Katy after the merger and diversions. Therefore, Katy protested the merger as not consistent with the public interest as required by statute and argued that it should not be approved as proposed.

However, Katy realized that the Commission is not limited to approving or disapproving a merger as proposed. It has the statutory power to change the terms of the proposed merger or impose conditions thereon so as to make the merger consistent with the public interest and thus be able to be approved. 49 U.S.C. § 11344(c) (See 360 I.C.C. at 950, A 253). Therefore, in

addition to asking that the merger as proposed not be approved, Katy alternatively asked the Commission to condition the merger so as to make it consistent with the public interest and Katy proposed the above described indemnity condition. It has been Katy's position throughout this proceeding that without protective conditions, its ability to continue to provide adequate service after the merger would be seriously adversely affected and that therefore the merger was not consistent with the public interest and could not lawfully be approved.

The Commission is not permitted to determine the public interest separately from the statutory standards therefor; rather, it is required to consider those standards, including the effect of the merger on adequacy of transportation, in determing if the merger is consistent with the public interest and can be approved.

McLean Trucking Co. v. United States, 321 U.S. 67, 76 (1944). In short, the Commission may not, as the Fifth Circuit found it did here, conclude that a merger is consistent with the public interest without considering aspects that could effect its impact. Port of Portland v. United States, 408 U.S. 811, 841 (1972); Missouri P. R.R. v. United States, 346 F. Supp. 1193, 1198 (E.D. Mo. 1972), aff'd, 409 U.S. 1094 (1973). The Court of Appeals' statements to the contrary indicate a change, without precedent or basis, in the statutory scheme for rail merger approval, and its opinion based thereon is in error.

## II

## THE COURT OF APPEALS ERRED IN AFFIRMING THE COMMISSION'S NEW "ESSENTIAL SERVICE" STANDARD FOR DETERMINING WHETHER TO PROTECT ADVERSELY AFFECTED RAILROADS

In its administration of the Interstate Commerce Act the Commission is obligated to carry out the National Transportation Policy, set forth in 49 U.S.C. § 10101. That Policy, which is concerned with the provision of "adequate" (as well as safe, economical and efficient) transportation, requires the encouragement of "sound economic conditions in transportation, including sound economic conditions among carriers." (emphasis added). The Act requires the Commission, in determining whether to approve a rail merger, to consider the effect of the merger on the "adequacy" of transportation service to the public and the effect of the merger on other railroads. 49 U.S.C. § 11344.

It has been in keeping with the concern as to "adequacy" of service, and the need to promote "sound economic conditions among carriers" -- including carriers adversely affected by a merger as well as the merger applicants -- that in approving rail mergers the Commission has historically provided protection for adversely affected roads, particularly when roads in a weak financial condition are adversely affected by the merger of financially strong ralroads. In the words of the Commission's own brief before the Court of Appeals in this case, the Commission, prior to the BN-Frisco case, sought to "guard against the destruction of those competitors or the serious curtailment of their capacity to provide service where their survival and the preservation of their service is needed in the public interest." This meant, over the years, the imposition of a large variety of conditions to protect adversely affected railroads, such as

special traffic solicitation arrangements, expansion of such railroads' opportunity for growth through the grant of trackage rights over the lines of the merged company, monetary indemnification against traffic losses, etc. (360 I.C.C. 950, A 253 and cases cited therein).

However, in the BN-Frisco decision, the Commission, while referring to the "adequacy" of transportation test, couched its conclusions as to the effect of the merger on other railroads in terms of their "essential" service, although neither the governing merger statute nor the National Transportation Policy refers at all to "essential" service. It was uncertain from the Commission's Report whether this represented a shift of substance, or whether the Commission was in effect treating "adequate" and "essential" as synonymous. In either event, the Commission made no finding that Katy's services were not "essential".

Before the Court of Appeals the Commission's brief sought to allay any fears that the use of the word "essential" represented a departure from either the statute or precedent. The Fifth Circuit's opinion, however, treats the "essential" service standard as constituting a "new standard" for the weighing of public interest considerations (632 F.2d at 401 n.21. A 31-32). That the Court is right in this regard has been recently confirmed by the Commission's latest statement of policy on rail consolidations, Railroad Consolidation Procedures, General Policy Statement, 363 I.C.C. 784 (January 28, 1981).

Thus, it is now clear that the Commission established in the BN-Frisco case a double standard: merger applicants will have their merger approved so long as the "adequate" transportation service test is met; other railroads, however, will be entitled to no protection unless harm is

shown to their "essential" services. See, e.g., 360 I.C.C. at 935, A 238:

> Adequacy of Transportation
>
> Approval of this merger, as conditioned, will have beneficial effect on the adequacy of transportation to the public. Not only will the services of the merged company be significantly improved, but other railroads will be able to continue providing essential services. [emphasis added]

The significance of this double standard is exemplified by the Commission's treatment of the impact of the merger on financial strength, with its consequent effect on the ability to provide satisfactory transportation service. As the Commission said, in adhering to the "adequacy" standard for the merger applicants, 360 I.C.C. at 937, A 240:

> A function of adequate transportation service to the public is the ability of a railroad to maintain its facilities. BN and Frisco currently do not have, and do not

> anticipate any difficulties in maintaining their facilities. The merged company will present an attractive target for investment. Thus capital should be available to finance necessary improvements to maintain its facilities. [emphasis added]

This conclusion was based on the fact that the merged enterprise, earning over $80 million a year based on the combined results of the merger applicants for the study year 1976 (360 I.C.C. at 997, 1020, A 300, A 323), would achieve additional net income of $33 million annually as a result of the merger (360 I.C.C. at 997, A 300).

In considering the situation of Katy, however, which had a net loss in 1976 and has been chronically in weak financial condition,[8] the Commission has considered a further net loss of $4.53 million a year by

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8. The Fifth Circuit noted that Katy's achievement of positive net income in 1978 was only the second significant income for the railroad in "nearly 75 [sic; i.e. 15] years". (632 F.2d at 397, A 15).

reason of the merger (360 I.C.C. at 1110, A 413) as insufficient to cause harm to Katy's "essential" services.

Although the Commission did not define "essential" service in the BN-Frisco case, its January, 1981 policy statement, 363 I.C.C. at 793, now states:

> A service is essential if there is a sufficient public need for the service and adequate alternative transportation is not available.

While this definition lacks total precision, its intent is clarified by comment of the Commission, 363 I.C.C. at 788, to the following effect:

> We have seen that the bankruptcy, liquidation, or abandonment of lines by a carrier does not necessarily mean the cessation of service to the public. The emergence of short line carriers and community owned or subsidized lines has demonstrated that where there is a demand for a service that service can be provided.

In reality, therefore, the purported provision for protection of "essential" service appears virtually meaningless. Since, in the Commission's view, when service is demanded, service will somehow be provided by someone -- another railroad (including the possibility of a new short-line operation following the bankruptcy of the protestant) government subsidized rail service, or other mode of transportation -- there will be few, if any, cases where a protesting railroad will ever be able to make the requisite showing that "adequate alternative transportation is not available." Contrary to the Commission's brief before the Fifth Circuit, the Commission is indeed departing a long way from its prior concern with the "serious curtailment" of the ability of other railroads to provide needed service and the possible "destruction of those competitors." Rather than seeking to

prevent the destruction of other railroads, the Commission now welcomes their bankruptcy.

Even if one were to assume that this shocking approach might be considered a permissible one for the Congress to adopt, it is not one which the Commission may validly establish under the existing statutory National Transportation Policy which is to promote, not destroy, sound economic conditions among carriers. In its treatment of the "essential" services standard, the Fifth Circuit's opinion fails even to discuss this aspect of the National Transportation Policy.[9] Moreover, the Commission made no finding that the admitted loss to Katy of

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9. The Court's reference (632 F.2d at 400, A 30) to the recent statutory encouragement of rail mergers in the Railroad Revitalization and Regulatory Reform Act (the 4R Act) overlooks the fact that the 4R Act was not intended to affect the standards or case law utilized by the Commission in its review of a merger application. Rept. No. 94-791, 94th Cong. 2d Sess., pp. 174-75.

$8.75 million in gross revenues annually would not adversely affect the "adequacy" of Katy's service.[10] The Court's conclusion that the "new weighing" of public interest considerations is not only permissible, but justifies a result which ignores the need for "sound economic conditions" among railroads adversely affected by the merger, and which ignores the effect of the merger on the "adequacy" of their service, is contrary to law.

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10. The Commission's finding as to the effect of the merger on Katy's "essential" service is discussed in Part III below.

## III

## THE COURT OF APPEALS ERRED IN AFFIRMING THE COMMISSION WHEN THE KEY FINDINGS SUPPORTING ITS CONCLUSION THAT THE MERGER COULD BE APPROVED WITHOUT PROTECTIVE CONDITIONS FOR KATY WERE NOT SUPPORTED BY SUBSTANTIAL EVIDENCE

### A. The Conclusion That Protection is Not Necessary Against the Loss of $8.75 Million In Gross Revenues Annually is Not Supported by Substantial Evidence or Adequate Findings

Despite the fact that Katy for many years has been "in very weak financial condition", suffers from a chronic deficit working capital position, and has large amounts of deferred necessary maintenance and capital investment (360 I.C.C. at 1118-20, A 421-23), the Commission assessed Katy's future prospects as "sufficient" to protect its "essential" service from the loss of $8.75 million a year in gross income which the Commission finds

that the merger would inflict. The Commission reaches this conclusion on the basis of three sketchily stated findings: (1) that Katy "potentially" will serve eight coal generating facilities on line, each generating $10 million in additional gross revenues for Katy a year, and that currently three of these units are on line increasing Katy's revenues by $26 million; (2) that Katy's massive rehabilitation program is nearly complete, so that its major expenditures over the past few years will be reduced to normalized maintenance costs; and (3) Katy's parent reimburses Katy for every dollar of Katy's tax loss which the parent uses (360 I.C.C. at 954-55, A 257-58). Despite the speculative nature of these conclusions and the lack of substantial evidence to support them the Court of Appeals affirmed the Commission's findings based on them.

It may be noted at the outset that the Commission's consideration of the coal traffic and rehabilitation program stems from evidence which Katy introduced concerning its ability to continue in operation and provide improved service despite its chronic financial weakness. The evidence shows that, in the absence of mergers of other railroads significantly disrupting Katy's traffic relationships, Katy could probably survive, a matter as to which, understandably, there has been doubt by reason of its long history of deficit operations. The evidence referred to the location on Katy's lines of new coal-fired power plants which would produce new coal business for Katy and the steps being taken by Katy, through a major infusion of Federal funds, to rehabilitate its badly deteriorated properties. The evidence made clear, however, that the losses inflicted by a BN-Frisco merger would dash these hopes completely and result in an

impairment of Katy's service (R326-R328, R534-R552).

(a) **Coal Traffic:** The Commission made no finding as to the net revenue effect of the existing coal traffic in respect of the three units referred to. In any event, Katy's projections as to the adverse impact of the merger on its working capital assumed, in the third year, the benefit of the full amount of $26 million of coal revenues (R147) to which the Commission points, and still Katy's already inadequate working capital would be worsened by $14 million in three years.[11]

Moreover, turning to the matter of five additional potential units, the record shows that neither of two units which may be added

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11. The Commission found Katy's loss of net income would be approximately 75% of that estimated by Katy in its evidence; hence the drop in working capital would also be approximately 75% of that estimated by Katy (See R407, R415, R629, R637 and 360 I.C.C. at 1110, A 413).

to a plant located at LaGrange (Halsted), Texas is expected to be in use before 1985 at the earliest (R148-R149); no contracts for their construction have been made (R657). The evidence as to the remaining three additional units at a plant in Pryor, Oklahoma is equally speculative, that is, that they will be built "sometime in the future" (R128). Thus there is no evidence beyond mere speculation to support the Court's affirmance (632 F.2d at 408, A 61) of the Commission's speculation that this "potential" increase in business will sufficiently protect Katy against the losses which the Commission found Katy would suffer.

Furthermore, whether these five additional units would use coal shipped by rail that would produce the gross revenues referred to by the Commission is even more speculative. The coal used by the three units on line or coming on line in 1981

moves or will move from BN points of origin in Wyoming (R127-R128), and Katy's division of the joint rate on such traffic is based on its haul of such coal from the interchange point to the destinations in Texas and Oklahoma (R127). However, in at least the case of the two additional units which might be built at LaGrange, lignite in Texas might be used instead of coal from BN origins (R127). There is no evidence of record as to whether the movements of coal or lignite would be by rail or some other form of transport such as coal slurry pipelines in which Katy would not even participate.

(b) **Rehabilitation and maintenance costs:** There is no finding by the Commission as to when the anticipated reduction in Katy's rehabilitation costs to normal maintenance costs will occur, and there is no finding as to what would be the amount, if any, of such reduction. While there is evidence in the record that it is hoped that

Katy's main line between Kansas City and Houston will be rehabilitated by 1982 (R121), this is only a goal which may not be accomplished; and there is no evidence of record as to when the additional rehabilitation of Katy's St. Louis line or its various branches and yards will occur. Further, it was expressly testified that the goal of completing rehabilitation of the Kansas City-Houston line by 1982 would not be attained if there were a drastic reduction of funds occurring by reason of the BN-Frisco merger (R132), and all of the rehabilitation is necessary if Katy is to be able to continue to provide adequate service.

Moreover, the statement of the Commission that present costs will be reduced when the rehabilitation is completed in the future takes no account of the mounting inflation in costs of normal maintenance, or of the fact that heavy

loading movements of coal traffic in unit trains on which the Commission relies might substantially increase maintenance costs (R125). The Commission failed to explain in findings adequate to justify upholding its Report as to how and as to what extent the conclusion as to future lower maintenance costs constitutes a "prospect" sufficient, alone or in conjunction with the "prospect" of increased coal revenues, to offset a $4.53 million loss in net income annually;[12]

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12. It must be kept in mind that this figure relates to 1976 traffic, revenue and costs, and it must be assumed that the figure would be significantly higher today as a result of the substantial inflation in costs experienced since then. Between January 1, 1977 and May 23, 1980, the Commission has authorized six general rate increases, which amount in the aggregate to an increase of 31.8%. See Increased Freight Rates and Charges - 1977, ICC Ex Parte No. 336 (1976); Nationwide Increased Freight Rates and Charges - 1977, ICC Ex Parte No. 343 (1977); Increased Freight Rates and Charges, Nationwide - 1979, ICC Ex Parte No. 368 (1979); Increased Freight Rates and Charges - Nationwide - 1980, ICC Ex Parte No. 375 (1980); Increased Freight Rates and Charges, 1978, 359 I.C.C. 821 (1979); and

and there is no evidence of record to support any conclusion that it would.

(c) **Income tax benefits:** The Commission misapprehended the workings of the agreement of Katy's parent company to reimburse Katy in respect of Katy's tax losses. The parent does not reimburse Katy for every dollar of tax loss Katy suffers (other than investment tax credits), but reimburses Katy only to the extent of tax benefit realized by the parent, which at present tax rates does not exceed 46% of the tax loss and the Commission made no finding as to what extent the parent may be able to use the losses in the future so as to be able to benefit from

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Increased Freight Rates and Charges, Nationwide - 8 Percent, 359 I.C.C. 740 (1978). In addition, the Commission has authorized numerous surcharges to overcome rising fuel costs, amounting to a total increase of 7.8%. See, e.g., Effect of Modifying Proclamation No. 3279 and Other Anticipated Energy Conservation Measures on the Operation of Carriers Subject to the Interstate Commerce Act, 350 I.C.C. 563 (1975), and various individual special permissions issued pursuant thereto.

Katy's tax losses. There was no finding as to what the expected amount of such losses will be and, while purporting to assess Katy's future prospects, the Commission makes no effort to assess the future prospects of the parent or the extent to which it may earn taxable income, even though such assessment would appear essential to the Commission's reliance on the use by the parent of Katy's tax losses to offset such income.

The Commission's use of the tax agreement with Katy's parent company as a basis for concluding that Katy's future "prospects" are sufficient to protect it is inappropriate indeed. The agreement was required by the Federal Government as a condition to granting Katy any of the rehabilitation funding which was necessary to overcome years of deferred maintenance in an effort to make its services adequate to the public (R547). Thus the form of protection

which the Federal Government insisted upon as a creditor because Katy's future prospects were not bright enough to justify the loans without that unusual protection is now being considered by the Commission as itself so bright a prospect as to justify denial to Katy of any protection from the major adverse effects of this merger, and to require the public dependent on Katy's service to suffer the results. To consider the stockholder's payment to Katy for the use of Katy's tax losses, which has been agreed to only because a creditor has insisted thereon as a condition to lending Katy any money, as a "bright prospect" for Katy's operations in the future which justifies denial of protection from the ravages of the BN-Frisco merger, is clearly without legal justification.

An administrative agency does not have unlimited discretion in reaching its conclusions. The basis of the

administrative process is that such decisions must be based on substantial evidence of record and that the agency must articulate the reasons for its decisions. Burlington Truck Lines, Inc. v. United States, 371 U.S. 156, 168 (1962) and cases cited therein. See 5 U.S.C. § 706(2). Here, Katy was denied the relief due it without either of those requirements being met. The Court of Appeals' view that the speculation of the Commission may be regarded as sufficient by the reviewing court because of a general reliance on its expertise and a reservation of power to impose protective conditions later is in error and should be reviewed and reversed by this Court.

### B. The Conclusion That the Gross Revenue Loss Would Not Exceed $8.75 Million Annually Is Not Supported by Substantial Evidence

The $8.75 million annual gross revenue loss found by the Commission is premised on the assumption that the DT&I conditions would be imposed on the merged BN-Frisco for the indefinite future, as had been the case in the past. This was made clear, for example, at the outset of the oral argument before the Commission on November 14, 1979 when counsel for the merger applicants stated (R173-R174):

> In the first place when the applicant initiated merger studies in this case, it was necessary to make certain assumptions regarding post-merger operations and one of the assumptions we made was that the DT&I conditions would be applicable. Our operating traffic studies were made on the basis that the DT&I conditions would apply to the post-merger operations.

Katy likewise assumed in its diversion study that the DT&I conditions would be imposed (R406).

That there is no basis in the record for concluding that Katy's gross revenue loss would not exceed $8.75 million in the third and subsequent years following merger is confirmed by the following colloquy in the oral argument before the Commission:

> COMMISSIONER ALEXIS: Are you saying that the traffic studies are predicated on the assumption that the Commission would impose DT&I conditions and you therefore have no information or information that you place value on on traffic diversion which would apply in the absence of these conditions?
>
> MR. LUCENTE [Counsel for the merger applicants]: That is correct, Commissioner. The traffic studies assume DT&I and the operating plan assumes DT&I so for that that reason I suggest that although the questions are comprehensive and probing, it is not possible on this record to get definitive comprehensive answers to those questions.

Nevertheless, the Commission decided, over the objections of two dissenting

Commissioners (360 I.C.C. at 964-65, A 267-68) to impose the DT&I conditions in this case for a period of only two years (360 I.C.C. at 957, A 260). Whatever the merits of the Commission's decision to limit the time period of the DT&I conditions as a matter of policy, the evidence herein is inadequate to support the finding that the maximum loss to Katy will be only $8.75 million a year, in view of the fact that all evidence on the subject of traffic diversion assumed the continuance of the DT&I conditions beyond a two-year period.[13]

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13. The Court's discussion of this subject, (632 F.2d at 404, A 44) reflects an erroneous reading of the record. Contrary to what the Court says in note 30, A 45 the question of Commissioner Alexis related directly to the issue as to whether the evidence of record--the traffic studies to which he referred--was adequate to provide credible information as to the amount of traffic diversion that would occur if the DT&I conditions were not imposed. The flat--and correct--answer of BN's counsel to the effect that there was no such information, because the traffic studies assumed that the DT&I conditions would be imposed, made it

The additional adverse impact on Katy of lifting the conditions might be substantial. In view of the fact that in the study year Katy earned revenues of $13.1 million on traffic interchanged with applicants, of which the Commission has found that $6.65 million would be diverted from Katy on the basis of evidence that assumed the continuation of the DT&I conditions, it follows that some portion of the remaining $6.45 million might be diverted as a result of the lifting of the DT&I conditions. There is no evidence of record, however, as to how much of that $6.45 million would be lost, and there is no finding by the Commission in this respect.

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unnecessary for counsel for the protesting railroads to make the same statement; it was already obvious from the statement of BN's counsel that any decision not to impose the DT&I conditions (or to impose them for only a period of two years) would "undermine other evidence," i.e. the sufficiency of the evidence of the traffic studies as to the effects of the merger once the DT&I conditions were lifted.

The Court of Appeals explicitly recognized that the Commission's evidence and projections are "completely unreliable" if substantial additional diversion occurs in or after the third year following the merger (632 F.2d at 405, A 52). However, it justified affirmance of the Commission's decision on the ground that "the Commission remains completely in control whether" such additional diversion occurs (632 F.2d at 406, A 56).[14] This is based on the Commission's reservation of jurisdiction to

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14. The suggestions of the Commission -- which the Court accepted at face value -- that other railroads may protect themselves by appropriate "responses" to the formation of the BN-Frisco system are worthless. The Commission, for example, exhorted other railroads to "develop new interline rates and services to meet the new competitive abilities of a merged BN-Frisco" (360 I.C.C. at 944, A 247). That this is hogwash is demonstrated by the Commission's own reasons for supporting this very merger: i.e., that BN and Frisco needed to combine because as separate carriers operating interline service they could not provide the benefits of single line service (360 I.C.C. at 936-37, A 239-40).

extend the DT&I conditions beyond two years if circumstances justify. The reservation, however, is essentially meaningless. As the Court itself notes, the Commission has instituted a proceeding looking to the elimination of DT&I conditions in all past proceedings, including BN-Frisco, which suggests the strong likelihood of their being eliminated even before the expiration of two years. If this occurs, the reliability of the Commission's evidence as to the first two years following merger, on which the Court's opinion depends, will obviously cease.

On the other hand, if the DT&I conditions remain in effect for the full two year period, the Court is wrong in suggesting that Katy is protected by having the opportunity to show "actual facts" to justify extension of the DT&I conditions. By hypothesis, the "actual facts" of additional diversion resulting from a lifting of the

DT&I conditions cannot be shown until after they are lifted, and the consequences thereof can be demonstrated. By that time, of course, the additional losses will have been suffered but any "protection" that may be imposed will be for the future following that demonstration; in other words, there will be no protection against the losses in fact shown.[15]

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15. The Court's conclusion (632 F.2d at 406, n.36, A 54) that 49 U.S.C. § 10705(d) furnishes Katy with "substantial safeguards" against diversion which the DT&I conditions would otherwise protect against is similarly erroneous. That statutory remedy would require separate Commission proceedings to challenge each rate or route cancellation which the merged company might make, and a separate finding as to the consistency with the public interest of each cancellation. There are literally thousands of routes and rates to which Katy is a party; and it is therefore doubtful that in the case of any particular rate or route there would be a sufficiently significant impact on Katy to justify denial of the cancellation. It is only through the cumulative effect of the DT&I conditions that adequate protection is provided.

While the Court concluded, but only with the aid of its "strongest bifocals" (632 F.2d at 407, n.38, A 58), that there was compliance with administrative law requirements in the Commission's handling of this question, we submit that the Court's rationalization of the result falls far short of supplying legal justification for the Commission's transparent error in failing even to consider whether Katy's future prospects are "sufficient to protect it" against a loss in gross revenue that may reach not merely $8.75 million but possibly as much as $15.2 million a year. The failure of both the Commission and the Court of Appeals to require any evidence to support the findings on which the merger is based should be reviewed and reversed by this Court.

## IV

**THE COURT OF APPEALS, IN CONFLICT WITH THE STANDARDS ANNUNCIATED BY THIS COURT AND OTHER COURTS OF APPEALS, ERRED IN HOLDING THAT THE COMMISSION'S ADOPTION AND RETROACTIVE APPLICATION OF NEW POLICIES WITHOUT WARNING DID NOT VIOLATE KATY'S RIGHT OF PROCEDURAL DUE PROCESS**

Katy, believing the merger would do Katy and its service great harm, formulated a proposed indemnity condition, and stated that this was the only condition, short of inclusion, which would fully protect it. Accordingly, it advanced no other proposal for a protective condition. The Commission's new policies against indemnification under any circumstances and of not imposing any condition unless requested by the protestant left Katy in the position where, for procedural reasons alone, it could not obtain any relief.

The power of the Commission to promulgate and enforce these new rules is

not questioned herein. What is contested is the Commission's power to announce such rules and then apply them retroactively in the same proceeding so as to deny Katy the relief due it. At least since SEC v. Chenery Corp., 332 U.S. 194, 203 (1947), this Court has encouraged administrative agencies to use the formal rule making process to promulgate general rules of prospective application and it has warned them to announce rules in adjudicatory proceedings and apply them retroactively only when necessary to protect the statutory scheme they are administering. See also Arizona Grocery Co. v. Atchison T.&S.F. Ry., 284 U.S. 370 (1932). The basic consideration in whether a court should allow an agency to apply a rule retroactively is the same as governs retroactive application of legislative statutes -- basic fairness -- except agencies are given less leeway and deference.

The Court of Appeals for the District of Columbia Circuit, in a widely followed opinion, has recently listed the considerations as to whether an administrative rule should be given retroactive effect:

> Among the considerations that enter into a resolution of the probelem are (1) whether the particular case is one of first impression, (2) whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of law, (3) the extent to which the party against whom the new rule is applied relied on the former rule, (4) the degree of the burden which a retroactive order imposes on a party and (5) the statutory interest in applying the new rule despite the reliance of a party on the old standard.

Retail, Wholesale and Department Stores Union v. NLRB, 466 F.2d 380, 390 (D.C. Cir. 1972).[16] Here, all of these factors weigh

16. Accord, Lodges 743 and 1746, International Association of Machinists v. United Aircraft Corp., 534 F.2d 422, 452-53 (2d Cir. 1975), cert. denied, 429 U.S. 825 (1976); Maceren v. District Director, 509

heavily against a retroactive application of the Commission's new rules: it is not an area of first impression where the Commission was forced to act without prior warning, it had acted in similar situations in the past; it is an abrupt departure from well settled practice, the Commission has often awarded a type of relief other than that requested and has provided for indemnity in previous cases, including provision on its own initiative; Katy relied heavily on the old rules, it would not have asked only for a type of relief the Commission would not grant if it knew by so asking it would not receive any relief; the heavy burden on Katy, denial of any protection

F.2d 934, 939-40 (9th Cir. 1974); Standard Oil Co. v. Department of Energy, 596 F.2d 1029, 1063-65 (Em. Ct. App. 1979). Cf. Transwestern Pipeline Co. v. Federal Energy Regulatory Commission, 626 F.2d 1266, 1271 (5th Cir. 1980) (Fifth Circuit citing SEC v. Chenery, supra, and Retail, W. & D.S. Union v. NLRB, supra, in approving a non-retroactive application of agency order).

against the merger impact, is obvious; and there is no statutory interest in the Commission choosing not to use powers given to it by Congress. In fact, the overriding consideration required to warrant retroactive application as set forth by this Court in SEC v. Chenery, supra, 332 U.S. at 203 - the need to insure a result consistent with the statutory design or legal and equitable principles -- is totally lacking in the Commission's retroactive application of its new rules. By ignoring these standards here the Fifth Circuit is in conflict with this Court and with the other Courts of Appeals concerning this important issue of administrative review.

The Court of Appeals concluded that these facts did not constitute a denial of due process essentially on three grounds (632 F.2d at 409-10, A 70-72), none of which is sound. First, it referred to the Commission's finding that no protection was

needed.[17] Clearly, however, this finding was made only in the context of the Commission's denial of relief because what Katy sought was the now-forbidden indemnification.[18] It is evident from another finding in the case that if Katy had requested lesser relief, in a different form than indemnity, the Commission might well have granted such relief. We refer to the Commission's approval of a condition for the benefit of the Chicago and Northwestern Company (CNW) (360 I.C.C. at 958, A 26). CNW is a substantially larger railroad than MKT ($529 million in operating revenues in 1976, the study year, compared with MKT's $101 million in operating revenues; 360

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17. As shown in Part III, this finding is not supported by substantial evidence.

18. The Commission stated first that the relief sought was indemnity which would not be granted as a matter of policy; it only then went on to say that, "additionally", protection is not required (360 I.C.C. at 954, A 257).

I.C.C. at 1116, 1123, A 419, A 426). CNW was projected by the Commission to suffer only a $1.7 million loss in net income as a result of the merger as against a $4.53 million net loss for Katy (360 I.C.C. at 1110, A 413). CNW appears in no weaker financial condition than Katy (360 I.C.C. at 1111-1124, A 414-27). Nevertheless, in CNW's case the Commission approved a grant of trackage rights to CNW over the BN's route, saving CNW the expense of rehabilitation of its own routes, and thus benefitting CNW and its service.[19]

There is, of course, no way of knowing on the basis of the record whether a condition less protective than full indemnity that Katy might have formulated would have

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19. While the merger applicants agreed to this condition, it does not appear that the condition was imposed for that reason. Conditions for other roads agreed to by the merger applicants were not imposed (360 I.C.C. at 957, A 260).

been approved by the Commission. But it certainly is unreasonable to conclude, particularly in the light of the condition imposed for CNW's protection, that because the Commission found Katy to have shown insufficient need for indemnity protection, no condition whatever would have been imposed had Katy been advised that indemnity was "out of bounds" and, accordingly, had proposed another form of protection.

The second basis for the Court of Appeals' decision has, if anything, even less merit. It finds Katy's reliance upon receiving indemnity "grossly misplaced" because it had only been imposed in two cases. The facts are, however, that both cases are of recent vintage, and in the more recent of them the protection had been granted to Katy itself, while no case at all denying indemnity is cited by the Court of Appeals; and, as the Court of Appeals had been informed, the Commission while adopting

a new policy against inclusion of an adversely affected railroad had kept entirely silent on the subject of indemnification at a time when it knew that Katy, and others,[20] in the BN-Frisco merger proceedings were seeking indemnification.[21] The Commission's silence on the subject of indemnity led (more properly, misled) Katy into believing that indemnity would be

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20. In addition to Katy, the Rock Island and the Milwaukee railroads requested indemnity (360 I.C.C. at 953-55, A 256-58).

21. A policy against inclusion, if there were any "reasonable alternative", was adopted in December, 1978. Railroad Consolidation Procedures, 359 I.C.C. 195 (1978), after having been proposed on February 1, 1978 in the Rail Merger Study (Final Report) of the Commission's Rail Services Planning Office. Pursuant to a procedural order in the BN-Frisco case served April 6, 1978, Katy was required to file its proposed conditions initially by April 27, 1978 and in final form by May 27, 1978. In neither of its releases in February or December, 1978, did the Commission indicate either that it would outlaw indemnity or that it would never impose any condition not specifically requested by a protestant.

regarded as a "reasonable alternative" to inclusion.

Finally, the Court of Appeals states that Katy can avoid any substantial adverse consequences by petitioning the Commission to provide protective relief "should the future show that the Commission's judgment was wrong" (632 F.2d at 410, A 71). However, as we have shown in our discussion of the CNW condition, it is doubtful that the Commission really determined that no protection of any kind would be justified if protection other than indemnity had been sought. Furthermore, the Commission has recognized that the reopening of a merger case to achieve protective conditions require "protracted proceedings before the I.C.C. during which period the protection sought to be afforded has ordinarily been lost". Chicago & N.W. Ry. - Control - Chicago, R.I. & P.R.R., 347 I.C.C. 556, 633-37 (1974). See Erie Lackawanna Ry.

v. Penn Central, 338 I.C.C. 513, 537-45 (1969) for an illustration of these difficulties. The Court of Appeals' conclusion is tantamount to holding that locking the barn after the horse is stolen constitutes adequate relief. Such a conclusion is in disregard of this Court's holding in Baltimore & O.R. Co. v. United States, 386 U.S. 372, 390 (1967), that the public interest in the assurance of adequate service requires that needed protection be provided before the harm resulting from a merger occurs. Katy submits due process was denied herein.

## CONCLUSION

The Court of Appeals' opinion represents a radical change in rail merger law. It is a change without statutory basis and in disregard of the National Transportation Policy. Whereas the governing statute is concerned with the "adequacy" of

transportation service and the encouragement of "sound economic conditions among carriers", now a new "test" as to "essential" service has been introduced which is apparently designed in disregard of the need for sound economic conditions among carriers not parties to the merger, and to make meaningless the "adequacy" test insofar as the effect of a merger on other railroads is concerned. Moreover, the Commission has applied its new test to circumstances where its findings as to lack of need of another road for protection of its service are unsupported by substantial evidence, and where, furthermore, the Commission has adopted new policies that have denied such other roads procedural due process.

Because of its importance to the National Transportation Policy and the nation as a whole, the opinion of the Court of Appeals should be reviewed by this Court. This Petition for a Writ of Certiorari should be granted and, upon review, the decision of the Court of Appeals should be reversed.

Respectfully submitted,


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February 23, 1981

# APPENDIX

MISSOURI-KANSAS-TEXAS
RAILROAD COMPANY,
Petitioner,

v.

UNITED STATES of America and
Interstate Commerce Commission,
Respondent.

RAILWAY LABOR EXECUTIVES'
ASSOCIATION, Petitioner,

v.

UNITED STATES of America and
Interstate Commerce Commission,
Respondents.

PEOPLE OF the STATE OF ILLINOIS,
Illinois Commerce Commission, Patrick
W. Simmons and M. S. Stuckey, Petitioners,

v.

INTERSTATE COMMERCE COMMISSION
and United States of America,
Respondents.

Nos. 80-1523, 80-1563 and 80-1692.

United States Court of Appeals,
Fifth Circuit.

Nov. 24, 1980.

Petitions for Review of an Order of the Interstate Commerce Commission.

Before THORNBERRY, GEE and REAVLEY, Circuit Judges.

REAVLEY, Circuit Judge:

In late 1977 Burlington Northern, Inc. (BN) and the St. Louis-San Francisco Railway Company (Frisco) applied to the Interstate Commerce Commission (ICC or the Commission) for authorization to merge pursuant to 49 U.S.C. §§ 11343 and 11344.[1] The Commission

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1. Section 11343 states, in pertinent part:

> (a) The following transactions involving carriers providing transportation subject to the jurisdiction of the Interstate Commerce Commission . . . may be carried out only with the approval and authorization of the Commission:
>
> (1) consolidation or merger of the properties or franchises of at least 2 carriers into one corporation for the ownership, management, and operation of the previously separately owned properties.

Section 11344 states, in pertinent

authorized the merger in a decision rendered

part:

(a) The Interstate Commerce Commission may begin a proceeding to approve and authorize a transaction referred to in section 11343 of this title on application of the person seeking that authority. . . .

(b) In a proceeding under this section, the Commission shall consider at least the following:

(1) the effect of the proposed transaction on the adequacy of transportation to the public.

(2) the effect on the public interest of including, or failing to include, other rail carriers in the area involved in the proposed transaction.

(3) the total fixed charges that result from the proposed transaction.

(4) the interest of carrier employees affected by the proposed transaction.

(c) The Commission shall approve and authorize a transaction under this section when it finds the transaction is consistent with the public interest. The Commission may impose conditions governing the transaction. . . . When a rail

in March 1980. No party to the proceeding sought administrative review. Instead, several of the protesting parties filed petitions in this court for judicial review of the Commission's decision,[2] and BN and Frisco intervened as respondents. The appellants challenge the Commission's standard of the "public interest," the existence of substantial evidence supporting certain

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carrier is involved in the transaction, the Commission may require inclusion of other rail carriers located in the area involved in the transaction if they apply for inclusion and the Commission finds their inclusion to be consistent with the public interest.

2. The Missouri-Kansas-Texas Railroad Company and the Railway Labor Executives' Association filed the original petition for review. The Soo Line Railroad Company and the Kansas City Board of Trade intervened as petitioners. A group of parties, to be designated as the "Illinois parties" herein, also jointly intervened: the People of the State of Illinois; the Illinois Commerce Commission; Patrick W. Simmons, Illinois Legislative Director of the United Transportation Union; and M. S. Stuckey, General Chairman for the United Transportation Union of Illinois Central Gulf Railroad.

projections, two new policy announcements, and a statutory interpretation regarding the scope of required employee protection. We have stayed the merger pending appeal, but we now affirm the Commission's decision.

## I. Statutory Provisions for Railroad Mergers

The Interstate Commerce Act (ICA or the Act) requires that the merger of railroads subject to the jurisdiction of the ICC may be accomplished only with the approval and authorization of the Commission. 49 U.S.C. § 11343. The Act's single and essential standard of approval is that the Commission find the merger to be "consistent with the public interest." 49 U.S.C. § 11344(c). The Commission is required to consider at least the following factors in a merger approval proceeding:

(1) the effect of the proposed transaction on the adequacy

of transportation to the public.

(2) the effect on the public interest of including, or failing to include, other rail carriers in the area involved in the proposed transaction.

(3) the total fixed charges that result from the proposed transaction.

(4) the interest of carrier employees affected by the proposed transaction.

49 U.S.C. § 11344(b).

The Commission must also consider as an element of "the public interest" the anti-competitive effects of a proposed merger, because § 11343[3] of the Act exempts

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3. Section 11343 was originally § 5(11) of

transactions approved by the Commission from the antitrust laws. United States v. ICC, 396 U.S. 491, 504, 90 S. Ct. 708, 714, 24 L.Ed.2d 700 (1970). When the Commission finds that a merger meets the "public interest" standard, it must approve the transaction. The Commission may, however, impose any conditions upon the merger that it wishes. 49 U.S.C. § 11344(c). These conditions may effectively re-distribute the merger's benefits to bring it within the public interest or enhance the degree to which the public interest is served, consistent with the relevant requirements of the Act.

The flexible procedure and standard that Congress provided in §§ 11343 and 11344 of the Act allow the Commission to adapt its policies and practices to the ever-changing

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the Act, which was recodified by Pub. L. No. 95-473, 92 Stat. 1337 (enacted October 17, 1978).

transportation needs of the public. But Congress has also enacted broad policy guidelines for the Commission, which it is required to consider in its task of identifying the public interest. McLean Trucking Co. v. United States, 321 U.S. 67, 82, 64 S. Ct. 370, 378, 88 L.Ed. 544 (1944). One is the national transportation policy, which says, in part:

> . . . [I]t is the policy of the United States Government to provide for the impartial regulation of the modes of transportation subject to this subtitle, and in regulating those modes--
>
> (1) to recognize and preserve the inherent advantage of each mode of transportation;
>
> (2) to promote safe, adequate, economical, and efficient transportation;
>
> (3) to encourage sound economic conditions in transportation,

including sound economic conditions among carriers;

(4) to encourage the establishment and maintenance of reasonable rates for transportation without unreasonable discrimination or unfair or destructive competitive practices;

(5) to cooperate with each State and the officials of each State on transportation matters; and

(6) to encourage fair wages and working conditions in the transportation industry.

49 U.S.C. § 10101. Congress provided another policy guideline in the Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act), in which Congress declared its purpose to encourage "efforts to restructure the [railway system of the United States] on a more economically justified basis . . . ." 45 U.S.C. § 801.

The legislative history of the 4R Act specifically states that it is "intended to encourage mergers, consolidations, and joint use of facilities that tend to rationalize and improve the Nation's rail system." S. Rep. No. 94-499, 94th Cong., 1st Sess. 20 (1975), Section 101(a)(2) and 101(b)(2), U.S. Code Cong. & Admin. News 1976, pp. 14, 34. Within these statutory standards and policies set forth by Congress, it is the unique task of the Commission to identify the specific factors, and their proper balance, that best serve the public interest as it changes through the years.4

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4. The Commission has chosen to announce the criteria, other than those set out by Congress, that it currently considers in determining whether a proposed railroad merger satisfies the public interest standard:

(1) Whether essential rail services will continue to be provided, either by the consolidating companies or by other railroads which may be affected by the consolidation ("essential services" include,

but are not limited to, those required by the national defense and those shown necessary to achieve other established national goals, such as energy conservation and rural and community development);

(2) Whether opportunities to achieve operating efficiencies will be increased;

(3) Whether redundant facilities will be eliminated;

(4) Whether the ability of the consolidated system to attract new business will be enhanced;

(5) Whether the consolidated company will be financially viable;

(6) Whether effective inter-and intramodal competition will be maintained wherever economic realities make it possible; and

(7) Whether there will by any adverse impact on the environment of the region served.

Railroad Consolidation Procedures, 359 I.C.C. 195, 199 (1978).

## II. Parties to the Commission Proceeding and this Appeal

Because the parties before the Commission and before us are numerous, we will briefly identify them and the roles they play.

### A. The Merging Railroads

Burlington Northern is a diversified transportation and natural resources company that is the largest railroad system in the United States in terms of miles, and the second largest in terms of transportation revenues. The principal lines of BN's 25,000 mile system extend east from Seattle and Portland to Montana, where two branches continue to Chicago. Through two subsidiaries, BN also serves Denver, Dallas-Fort Worth, and Galveston. Since 1970 BN has compiled a good traffic and revenue growth

record. Net railway revenues in 1976[5] were about $72.6 million. Frisco, the railroad to be absorbed into BN, has about one-fifth the track mileage of BN. Operating mainly as a link between other carriers, Frisco provides service from St. Louis and Kansas City to Wichita, Memphis, Birmingham, and Pensacola. It also runs from Springfield, Illinois through Kansas and Oklahoma to Dallas-Forth Worth. Frisco connects with BN subsidiaries at four points in Texas: Dallas, Forth Worth, Irving and Quanah. Frisco's net income in 1976 was $12 million.

Because BN and Frisco are not competitors on parallel routes, their proposed merger is of an "end-to-end" form, greatly extending for both railroads the markets

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5. Comparisons of railroad revenues will be based on 1976 figures, the most recent year available at the time data was assembled for the ICC in 1977 and 1978.

they can reach, for which they may then offer more efficient service and lower "single-line" rates. Other operating efficiencies and innovations made possible by the merger would enable the merged railroad to achieve net revenue gains of about $33 million a year, including traffic diversions from competitors of about $16.8 million.

B. Protesting Railroads and Other Parties

The railroad that will probably face the greatest challenge in dealing with increased competition from the merged BN-Frisco is the Missouri-Kansas-Texas Railroad Company (Katy). Katy serves Missouri, Kansas, Oklahoma, and Texas, with its main lines running south from Kansas City and St. Louis through Dallas-Fort Worth to San Antonio and Houston. Katy's traffic volume and operations have changed little since the

1950's, and its net income of $2.4 million in 1978 was only the second significant income for the railroad in nearly 75 years. Katy acknowledges, however, that it has begun to "turn the corner" as a result of improving business in its territory and a substantial rehabilitation of its facilities aided by $38 million in federal funds.

The Soo Line Railroad Company (Soo) operates 4,600 miles of railroad in Montana, North and South Dakota, Minnesota, Michigan, Wisconsin, and Illinois. These routes place Soo in direct competition with BN. Soo is an economically strong carrier, and had a net income of almost $19 million in 1976.

The non-carrier appellants are as follows: (1) the Railway Labor Executives' Association (RLEA), a voluntary, unincorporated association of the chief executive officers of most of the nation's rail labor organizations; (2) the Kansas City Board of Trade (KCBOT); and (3) a group of joint

intervenors representing Illinois interests (Illinois parties).[6]

## III. I.C.C. Proceedings and Opinion

BN and Frisco filed their merger proposal with the ICC in late December 1977. The Commission accepted the filing in January 1978 and waived an initial decision by the administrative law judge. 43 F.R. 3799 (1978). Thus the merits of the applications were determined by the Commission itself, as provided by statute when an application "is of major transportation importance." 49 U.S.C. § 11345(e).

Public hearings were conducted before an administrative law judge from May 1978 through June 1979. In October 1979 the administrative law judge closed the record and certified it to the ICC. The Commission heard oral argument on November 14, 1979.

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6. The Illinois parties are identified in note 2.

The total record reflects 46 days of hearings and comprises 8,370 pages of transcript and 222 exhibits received in evidence.

The Commission released its opinion on April 17, 1980, authorizing the merger subject to specified conditions. Burlington Northern, Inc.--Control and Merger--St. Louis--San Francisco Ry. Co., 360 I.C.C. 784 (1980). Because the opinion is the essential subject of this judicial review, it is necessary to outline its contents in some detail.

The Commission first discussed the two applicant railroads and the terms of the proposed merger. The opinion set out the impact and benefits of the merger as projected by the applicants in each of ten major areas: diversion of traffic and revenues from other carriers, increased costs, changes in operations, savings in purchasing and materials, benefits to shippers and the

general public, securities transactions, impact upon employees of the applicants, impact upon national defense, overall financial consequences, and environmental impact. 360 I.C.C. at 805-32, 945-46. These analyses were based upon extensive data that the Commission requires all merger applicants to prepare. 49 C.F.R. §§ 1111.1-.3.

The Commission next analyzed in detail the positions of all other parties to the proceeding. Ten competitor railroads of BN and Frisco had negotiated protective conditions with the merger applicants and informed the Commission that they would not oppose the merger if the stipulated conditions were imposed. In addition to Katy and Soo, four other railroads opposed the merger,[7] but these four carriers chose not

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7. The four railroads were the Chicago, Rock Island and Pacific Railroad Company; the Chicago, Milwaukee, St. Paul and Pacific

to appeal the Commission's decision to this court. The remaining parties opposed to the merger were the RLEA and the KCBOT--both petitioners in this appeal--and six other public and private parties who did not join the appeal.[8]

The two most significant non-carrier parties in favor of the merger were the Department of Defense and the Department of Justice. The Department of Justice stated that it found no significant anticompetitive effects from the merger, based upon the extensive analysis of projected traffic and revenue diversions. The Department noted that all of the competitor railroads could

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Railroad Company; the Illinois Central Gulf Railroad Company; and the Denver and Rio Grande Western Railroad Company.

8. These public and private parties were the Iowa Department of Transportation, the Illinois Department of Transportation, the Montana Wheat Research and Marketing Committee, John W. O'Neil (representing Frisco shareholders), the United Transportation Union, and the Railway Employees' Department of the AFL-CIO.

survive the diversions without serious damage to their operations or financial stability, with the possible exception of Katy. The Department concluded, with a marked lack of sentimentality, that Katy could restructure if it did not survive and, in any event, Katy's presence would not be missed in the competitive climate of its service areas. 360 I.C.C. at 917-20.

Having closely reviewed and analyzed the positions of all the parties, the Commission reviewed the criteria of merger approval contained in the relevant statutes and in the Commission's own policy statements.9 The opinion then analyzed specific findings and conclusions about the benefits to the public from the proposed merger. The Commission found that the BN-Frisco merger was very strongly in the public interest.

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9. See the discussion set out in section 1, above.

The merged BN-Frisco will be able to provide a new single-line service between the Southeast and Northwest, reduce transit times, provide more frequent and efficient service, and greatly improve car utilization. The improved service will stimulate innovative rates and service improvements among other carriers. No competing carrier will be so adversely affected that it could not continue to provide "essential services" to the public. 360 I.C.C. at 934-41.

Katy, Soo, and the four other protesting carriers had asked the Commission to impose special protective conditions on the merger that would relieve them from the impact of the increased competition or improve their competitive position.[10] The Commission

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10. Soo, for instance, made extensive requests for the opening of new connections with the merged BN-Frisco, new trackage rights over BN-Frisco tracks without payment of any rent by Soo, termination of a 1929

denied all requests for special protective conditions, but did impose on the merger for a period of two years the set of standard traffic protection conditions, known as "D.T. & I conditions,"[11] that have been imposed on nearly every railroad merger in the last 30 years. The D.T. & I. conditions generally ensure that a merged railroad will (1) continue to handle the interconnecting traffic of other railroads with the same neutrality as before the merger and not favor its new partner at the expense of a non-merged railroad, and (2) not close routes or rates previously maintained with a competing railroad without the Commission's approval.[12] The Commission also imposed

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pooling agreement between Soo and BN's predecessor company, and six other special conditions.

11. The name is taken from the first case in which the Commission imposed this set of protective conditions, Detroit, Toledo & Ironton R.R. Co.-Control, 275 I.C.C. 455 (1950).

12. The D.T. & I. conditions prohibit both

upon BN and Frisco for two years the conditions that they had negotiated and stipulated with the ten non-objecting railroads. 360 I.C.C. at 950-58, 1179-80.

The order approving the merger subject to these conditions was to become effective 30 days from the date of its service. BN and Frisco announced their intention to consummate the merger on May 19, 1980. Katy and the RLEA, subsequently joined by the other petitioners, sought review in this court and asked the Commission to stay its order pending judicial review. The Commission refused. This court imposed a stay, however, and set the case for expedited briefing and argument. Petitions by BN and Frisco to vacate the stay were

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direct and "commercial" closing of routes and rates. For instance, if carrier A negotiates an interline rate with carrier B, and then carrier A and carrier C merge, A and C cannot close B's interline rate, nor can they offer a lower rate (a "commercial closing") without offering the same rate to carrier B or gaining Commission approval.

denied by this court and by the United States Supreme Court. Burlington Northern, Inc. v. Missouri-Kansas-Texas Railroad, ____ U.S. ____, 100 S. Ct. 3007, 65 L.Ed.2d 1110 (1980).

IV. Issues on Appeal

None of the petitioners directly challenge the Commission's ultimate conclusion that the BN-Frisco merger is in the public interest. The validity of that conclusion is threatened only indirectly, by challenges to subsidiary findings, conclusions, and orders of the Commission. The six issues raised by the parties are as follows:

1) Did the Commission apply a proper statutory standard in looking to the preservation of "essential rail services" rather than the preservation of corporate entities?

2) Did the Commission's limitation of D.T. & I. conditions to two years nullify

the substantial evidence supporting any other finding or conclusion?

3) Did the Commission err in denying the special protective conditions sought by Katy and Soo?

4) Was it arbitrary and capricious and an abuse of discretion for the Commission to announce and apply in this case its new policy determination that (1) indemnification of competitor railroads is not a viable condition "under any circumstances" and (2) a carrier will not be granted any protective condition that it did not request?

5) Did the Commission give adequate consideration to the anticompetitive effects of the merger, especially in encouraging other mergers?

6) Did the Commission properly hold that the Interstate Commerce Act only requires it to consider protection for employees of the

merging carriers, and not for employees of other carriers?

## V. The Standard of Judicial Review

The Administrative Procedure Act, 5 U.S.C. § 706, governs the scope of our review of an agency decision. We are directed to

> "(2) hold unlawful and set aside agency action, findings, and conclusions found to be--
>
> (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; . . . [or]
>
> (E) unsupported by substantial evidence . . . ."

"Substantial evidence" means "enough to justify, if the trial were to a jury, a refusal to direct a verdict when the conclusion sought to be drawn from it is one of fact for the jury." Illinois Central Railroad v. Norfolk & Western Railway, 385 U.S. 57, 66, 87 S. Ct. 255, 260, 17 L.Ed.2d 162 (1966).

The APA and the Interstate Commerce Act are integral parts of a congressional intent that the Commission use its extensive facilities, broad experience, and expert judgment to make the complex decisions necessary to evaluate whether a railroad merger is consistent with the public interest. It is not our task to re-weigh the evidence or to draw our own inferences from the evidence before the Commission. Chicago, St. Paul, Minneapolis & Omaha Railway v. United States 322 U.S. 1, 3, 64 S. Ct. 842, 843, 88 L.Ed. 1093 (1944). We can ask only whether the Commission has observed the statutory limits that Congress has set for its discretion, whether its action was arbitrary or capricious, or whether its findings are supported by adequate analysis and substantial evidence in the record considered as a whole. McLean Trucking Co., 321 U.S. at 87-88, 64 S. Ct. at 381. If a Commission

action meets these broad standards, then our task is at an end.

## VI. Discussion of the Issues Raised

### 1. The "Essential Services" Standard

The Commission's fundamental task under § 11344 is to decide whether a merger is "consistent with the public interest." One of the most difficult decisions of the Commission is the degree to which the benefits for the merging railroads should be diminished through the device of protective conditions in order to insulate weaker competitors. In prior years the Commission believed that the preservation of service in general, and of the corporations providing that service in particular, was an end that justified protective conditions for weaker carriers. Consequently, the Commission would impose conditions on a merger merely

to protect the market shares of competing carriers,[13] to compensate a carrier for anticipated losses,[14] to improve the position of a carrier,[15] or to aid carriers even though they were not likely to be harmed by the subject merger.[16]

The Commission has begun to move away from this liberal use of protective conditions, perhaps in response to the growing public consensus that the transportation industry should be shaped more by the realities of the marketplace and less by government regulation-as shown by recent

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13. See, e.g., Chicago & North Western Ry. -Control-Chicago, Rock Island & Pacific R.R., 347 I.C.C. 556 (1974); Illinois Central Gulf R.R.-Acquisition-Gulf, Mobile & Ohio R.R., Illinois Central R.R., 338 I.C.C. 805 (1971); Pennsylvania R.R., 327 I.C.C. 475 (1966).

14. Chicago & North Western Ry., 347 I.C.C. 556 (1974).

15. Great Northern Pac.-Merger-Great Northern, 331 I.C.C. 228, 280-81 (1967).

16. Louisville & N.R.R.-Merger-Monon Railroad, 338 I.C.C. 134 (1970).

congressional deregulation of the airline,[17] trucking,[18] and railroad industries.[19] The Commission's re-evaluation of policy began as early as February 1977, when the Commission directed its Rail Services Planning Office (RSPO) to conduct a nation-wide study of railroad mergers, prompted by a recognition that 4R Act had expressed Congress' intent to encourage railroad consolidation.[20]

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17. Airline Deregulation Act of 1978, Pub.L.No. 95-504, 92 Stat. 1705 (1978).

18. Motor Carrier Act of 1980, Pub. L.No. 96-296, 94 Stat. 793 (1980).

19. Staggers Rail Act of 1980, Pub.L.No. 96-448, 94 Stat. 1895 (1980).

> We have reviewed the present case under existing law prior to the October 1, 1980 effective date of § 228 of the Staggers Rail Act of 1980. See Report of the Committee on Conference, H.R. Rep. No. 96-1430, 96th Cong., 2d Sess. 142 (1980). That statutory change, however, would have no effect on our conclusions.

20. See the discussion at the end of section I. above.

After a preliminary report and public hearings the RSPO issued its Final Report in February 1978. The report recommended that the Commission adopt a policy that it would no longer impose conditions on a merger merely to preserve weak carriers, but only to preserve essential services to the public, regardless of who provides them. Rail merger Study-Final Report (Rail Services Planning Office) (February 1, 1978), pp. 38-39.

The Commission formulated a policy statement based upon the RSPO recommendation, published it in proposed form, 43 F.R. 15753, and released its final policy in Railroad Consolidation Procedures, 359 I.C.C. 195 (1978).[21] This document stated

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21. The Commission denies in its brief that the "essential services" standard was a new policy. Nothing in our opinion turns on that question. We nevertheless reject that argument by the Commission because the RSPO Final Report, the Commission's own 1978 policy statement, and the BN-Frisco opinion

that

> "[t]he Commission believes that the railroad consolidation process should not be used as a means for preserving the system of financially weak and marginal railroads or for protecting them from undergoing reorganization, if necessary, under the bankruptcy laws. The Commission is concerned with the preservation of service, not of companies or railroad systems .... If it appears that the end result of a proposed railroad consolidation would be the permanent cessation of essential services by some other railroad, the Commission may deny the consolidation application or condition its approval upon the willingness of the applicants to restructure the proposal." (emphasis added)

359 I.C.C. at 199-200. This is a more lenient standard of merger approval because an application will no longer be denied or conditioned merely if it harms competitors, but only if it harms them to a degree that they cannot provide "essential services."[22]

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itself all make it abundantly clear that a new policy has been developed. See, e.g., BN-Frisco, 360 I.C.C. at 950-52.

22. The Commission specifically noted that

The Commission applied the new "essential services" standard throughout its BN-Frisco opinion,[23] consistently finding

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such a policy statement

> does not establish a binding norm, and it is not finally determinative of the issues or rights which it discusses. When the policy enunciated in the statement is applied in a specific proceeding, parties to that proceeding will have the opportunity to challenge or support the policy through appropriate evidence or argument.

Railroad Consolidation Procedures, 359 I.C.C. at 196.

23. See e.g., the following:

(1) "The merger of Frisco into BN presents us with just such an opportunity-two railroads voluntarily initiating a transaction that will reduce their costs and improve utilization of equipment and facilities without eliminating essential services," 360 I.C.C. at 935;

(2) "Not only will the services of the merged company be significantly improved, but other railroads will be able to continue providing essential services," 360 I.C.C. at 935;

(3) "We will protect impacted carriers simply because they find themselves in a situation where they must

that the merged BN-Frisco would not eliminate any of its own essential services, 360 I.C.C. at 935, and that no competitor would be harmed to a degree that it could not provide essential service, id. On this appeal, the Illinois parties challenge the application of this new standard on the ground that it violates the statutory mandate. Essentially, their argument is that Congress did not intend a lenient

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actively compete. As stated in our policy statement, we look only to preservation of essential rail service when imposing protective conditions, not to the protection of corporate entities," 360 I.C.C. at 944;

(4) "We do not believe that a merger should be conditioned unless essential services have been shown to be affected ...," 360 I.C.C. at 951; and

(5) "The Commission has imposed indemnity conditions when it was concerned about preserving existing service ... We no longer require that corporate entities be preserved; rather we are concerned about essential services," 360 I.C.C. at 952.

"essential service" standard of merger approval for § 11344 proceedings, but only for the separate, expedited consolidation procedures that it created in § 11346.[24] The Illinois parties argue that the Commission has "lifted" the essential services standard from § 11346 into § 11344, contrary to congressional intent.

This argument is without merit. The truth of the matter is that the "essential services" standard appears nowhere in either § 11344 or § 11346, or their legislative

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24. Section 11346 allows certain carriers to use its expedited procedures for merger approval before January 1, 1982. The time limit was intended to encourage speedy rationalization of the nation's rail system.

The expedited procedures allow the Commission to name a panel that must make a recommendation on the merger within 180 days. The Commission must then act on the recommendation within 120 days. The Commission approves or denies the merger if it is "in the public interest," and does not have to consider the specific factors enumerated in § 11344(b). 49 U.S.C. § 11346.

histories. It was a creation of the RSPO[25] as a new weighing of subsidiary factors within the public interest standard, and was properly adopted by the Commission on its own merits. Congress intended mergers initiated under either section to be evaluated by the "public interest" standard specifically stated in both.[26] The Commission has

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25. The RSPO apparently believed that "the preservation of essential service" was "emphasized" in § 11346, in contrast to the Commission's policy of ensuring the survival of marginal carriers by forcing their inclusion in mergers proposed by stronger lines. RSPO Final Report at 38. But the RSPO cited no authority for finding this "emphasis" in § 11346, and none has been cited to us by any party on appeal. It matters not, however, because the Commission adopted and adequately explained its essential services standard without any mention of Congressional authorization from § 11346. Railroad Consolidation Procedures, 360 I.C.C. at 195-200. Because this policy was adopted with the proper explanation and is clearly within other statutory guidelines, it stands on its own feet, regardless of what the RSPO thought § 11346 "emphasized."

26. The Illinois parties attempt to find some basis for distinction between §§ 11344 and 11346 in the fact that the former says "consistent with the public interest" while the latter says "in the public interest."

determined that the public interest standard is the same in both sections, Railroad Consolidation Procedures, 359 I.C.C. at 199, and that the preservation of essential services is one component of the same public interest standard, id. Section 11346 is more "lenient" only in that it expedites the merger approval procedurally and relieves the Commission of the duty to consider the four factors required in § 11344(b).27 We reject the contention of the Illinois parties. The Commission is free to apply an essential service standard as a component of the "public interest" under either § 11344 or § 11346.

The Illinois parties next argue that the essential service standard violates the Commission's obligation to consider "the

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There is no legislative history or other statutory basis whatsoever to support this strained argument.

27. Section 11346 is summarized in note 24.

effect of the proposed transaction on the adequacy of transportation to the public." 49 U.S.C. § 11344(b)(1). Soo repeats that objection and also contends that the new standard (1) violates the national transportation policy and the Commission's responsibility to protect the total public interest under § 11344; and (2) violates 49 U.S.C. § 10101, which establishes the national transportation policy of ensuring "the development, coordination, and preservation of a transportation system that meets the transportation needs of the United States." Neither the Illinois parties nor Soo offer any more specific or substantial arguments on behalf of these contentions. Instead, Soo debates procedural objections that we discuss below, and the Illinois parties argue only that the new standard "unleashes ruinous market forces," pointing to the loss of one train daily between Centralia and Galesburg, Illinois.

Without more assistance from the parties, we can find no inconsistency between the essential services standard and the "adequate transportation" consideration mandated by § 11344(b)(1), or any other statutory requirement cited by Soo. As stated above, the decision to approve a merger or impose protective conditions always involves a balance of improved service and carrier strength in the merging railroads against possible decreased service and carrier strength in competitor railroads. In the past, the Commission would deny a merger or dissipate its benefits in the form of protective conditions merely if a competitor were harmed or lost a share of the market.[28] The essential services standard represents a new weighing of those same factors: a merger that is

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28. See, e.g., the Commission opinions cited in notes 13-16.

otherwise beneficial to the public will not be denied or conditioned unless essential services to the public are lost. Railroad Consolidation Procedures, 359 I.C.C. at 198-200. The Commission has determined that the public will benefit in overall service if competing carriers are less shielded from the need to face the challenge of strong merged carriers. Burlington Northern, Inc.-Control and Merger, 360 I.C.C. at 950-52. In order to gain that overall benefit for the public, the Commission has decided that only "essential services" should be protected. We find that new weighing of the public interest perfectly appropriate under § 11344(b)(1) and any of the other broad statutory standards. Furthermore, it is exactly the kind of sensitive re-evaluation of "the public interest" that Congress intended the Commission to undertake. American Trucking Association, Inc. v. Atchison, Topeka, and Santa Fe Railway, 387

U.S. 397, 416, 87 S. Ct. 1608, 1618, 18 L.Ed.2d 847 (1967).

Soo finally objects to the essential services standard because it is a departure from the Commission's longstanding policy to impose protective conditions merely to preserve the competitive ability of non-merging carriers. But it is established beyond argument that an agency may change its policies so long as it identifies and articulates its reasons for doing so. As the Supreme Court has stated in another ICC case:

> [W]e agree that the Commission, faced with new developments in light of reconsideration of the relevant facts and its mandate, may alter its past interpretation and overturn past administrative rulings and practice. [citations omitted.] In fact, . . . this kind of flexibility and adaptability to changing needs and patterns of transportation is an essential part of the office of a regulatory agency. Regulatory agencies do not establish rules of conduct to last forever; they are supposed, within the limits of the law and of fair

> and prudent administration, to adapt their rules and practices to the Nation's needs in a volatile, changing economy. They are neither required nor supposed to regulate the present and the future within the inflexible limits of yesterday.

American Trucking Associations, 387 U.S. at 416, 87 S. Ct. at 1618.

The Commission must explain its departure from previous policy so that a reviewing court may determine that the decision is reasoned and not arbitrary. Burlington Truck Lines v. United States, 371 U.S. 156, 167-68, 83 S. Ct. 239, 245, 9 L.Ed.2d 207 (1962). But the Commission abundantly fulfilled that task in its 1978 policy statement and in the BN-Frisco opinion itself.29

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29. The relevant discussion from the 1978 policy statement, Railroad Consolidation Procedures, 359 I.C.C. at 199-200, was quoted in the fourth paragraph under VI.1.

In the BN-Frisco opinion, the Commission reviewed its more liberal use of protective conditions in prior mergers, then said

> This has been our policy in the past.

Having concluded that the "essential

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However, the overriding factor governing the imposition of all conditions in the past has been the public interest. We would be remiss if we did not consider today's limits when imposing conditions on a railroad merger instead of viewing the industry as static.

. . . The voluntary consolidation of more than one railroad, when properly conceived and executed, is expected to yield certain benefits to that railroad. Any condition imposed on that merger tends to decrease or eliminate the merger's expected benefits . . .

As we have said, railroads do not have a proprietary right in the future to the traffic they have carried in the past. Therefore, we need not protect railroads from the possible loss of traffic through diversion to a merged railroad. On the contrary, protecting competitive railroads tends to limit a shipper's ability to obtain the best service from the merged company and dampens the incentives for competitive response to the merged company from existing railroads. . . .

We have stated that we would not impose conditions solely to compensate carriers for diversion or protect them from the risks of competition. In connection with transactions such as this, it is not practicable, nor would it be in the public interest, to impose conditions calculated to freeze the flow of traffic into a preexisting pattern or to protect

services" standard is clearly within statutory guidelines and has been adequately explained, our review of that issue is complete.

2. **The limitation of D.T. & I. Conditions.**

In virtually every merger approval since 1950, the Commission has imposed D.T. & I. conditions permanently, while retaining jurisdiction to amend or remove the

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competing and connecting carriers against all possible adverse effects which might follow from the unification and resulting improvements in service by the surviving corporation. Such action would prevent, to a substantial extent, the effectuation of service improvements to which the shipping public is entitled, and would unduly restrict the unified company in its solicitation and routing of traffic under development of a strong competitive system.

We do not believe that a merger should be conditioned unless essential services have been shown to be affected . . . .

360 I.C.C. at 950-51.

conditions at any time. Thus all of the parties to this proceeding assumed the existence of "permanent" D.T. & I. conditions in preparing economic data and traffic diversion projections for the Commission's use. After the record was closed, however, the Commission informed the parties in its order setting the case for oral argument that it might approve the merger without permanent D.T. & I. conditions. No parties objected during the course of oral argument before the Commission that this decision might undermine other evidence.[30] Prior to the release of the BN-Frisco opinion, the

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30. In fact, no party even mentioned that a decision not to impose permanent D.T. & I. conditions would affect other evidence. In the course of oral argument by the BN counsel on another issue, Commissioner Alexis interjected the question whether BN was saying that it had no evidence as to the diversions that would occur in the absence of D.T. & I. conditions. Counsel answered in the affirmative, but the issue was never developed or even mentioned again in the entire record.

Commission announced in Seaboard Coast Line Railroad, et al.-Investigation of Control and Modification of Traffic Conditions, 360 I.C.C. 582, 603 (1979), appeal pending on other grounds, 5th Cir. No. 80-5030, that is was adopting the "essential services" standard in relation to D.T. & I. conditions and would entertain petitions for the removal or modification of conditions imposed in prior mergers. The Commission also announced in Seaboard that it now interprets the Interstate Commerce Act to provide most of the same protection against unfair carrier practices previously offered by D.T. & I. conditions.[31]

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31. See note 12 and the accompanying text for examples of the unfair practices prohibited by D.T. & I. conditions.

The Commission's new interpretation of the Act was stated as follows:

> We acknowledge that the railroads are a highly interdependent network and that open routings, gateways, and interchanges are essential. In the past we

In the BN-Frisco opinion, the Commission took the unusual action of imposing D.T. & I. conditions and retaining jurisdiction for a two year period only. Katy, Soo, and the Kansas City Board of Trade object on appeal that this two-year limitation

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have used the DT&I conditions to prevent the closing of routes and gateways and to prohibit discrimination at interchanges. We now believe that this practice is overly broad, in view of the changes in the industry's structure over the last 15 years. The Interstate Commerce Act provides the needed protections of particular interchanges and services, and in the future, we will enforce the statutory provisions to assure open routing, gateways and interchanges. See 29 U.S.C. 11101 (formerly section 1(4)), imposing the common carrier obligation to provide service and to establish reasonable through routes and rates; 49 U.S.C. 10741 (formerly section 3(4)), requiring equal interchange facilities; and 49 U.S.C. 10705 (formerly sections 15(3) and (4)) authorizing the Commission to establish through rates, joint rates and the division of joint rates. Evidence relating to the need for protection against predatory or unfair competitive practices can be submitted with a complaint filed under these provisions.

Seaboard, 360 I.C.C. at 603.

nullified the Commission's substantial evidence as to the effects of the merger after the second year, because all of the data before the Commission assumed that D.T. & I. conditions would be imposed indefinitely.

For the purpose of discussion, it will be helpful to distinguish two kinds of traffic diversions involved in this question. The first is the kind of diversion that is inherent in the merger with or without D.T. & I. conditions, merely because the single-line BN-Frisco service will be faster or more efficient than parallel service over Katy or Soo that must interconnect with BN-Frisco or some other carrier. All the parties agreed that these diversions, which we will call "inherent" diversions, would be effected only over a three-year period, presumably because of the time necessary to integrate the two lines and make shippers aware of the benefits. The second type of

diversion would be possible only when D.T. & I. conditions were lifted, so that the BN-Frisco could, subject to several contingencies discussed below, close routes or rates it previously maintained with Katy or Soo, for example, and take that traffic entirely for itself. We will call this second type "post-D.T. & I." diversions.

The Commission made a specific finding, based on the projections of all parties, that 95% of the "inherent" diversions would be achieved by the end of the second year, 360 I.C.C. at 1108, when D.T. & I. conditions would still be in place. It is therefore fair to say that the Commission had substantial and reliable evidence as to 95% of the diversions that will occur because of the benefits that are inherent in the merger itself. If any post-D.T. & I. diversions occur--and that is very much open to question, as we discuss below--they will involve a simple transfer of traffic and

revenues from the weaker competitor to the stronger BN-Frisco. Thus the benefits of the merger to BN-Frisco and to the public it serves could only be increased by post-D.T. & I. diversions. The negative effects of these diversions would be solely a question of lost traffic and revenues to the weak carriers, which can be remedied entirely by adjustments to the protective conditions themselves, rather than by reassessing the entire merger. Consequently, the Commission's substantial evidence supporting the approval of the merger itself is unaffected by the decision to limit D.T. & I. conditions.[32]

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32. Katy and Soo have argued that any current doubt about the Commission's decision regarding the need for protective conditions also calls into question the Commission's approval of the entire merger, because the Commission might decide that the merger is not in the public interest with the particular protective conditions it might find necessary to protect competing carriers. We disagree. The Commission obviously viewed the approval of the merger as a decision

If the limitation of D.T. & I. conditions nullified substantial evidence used by the Commission, the only decision affected would be the conclusion that the competing carriers had no need of special

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quite distinct from any future changes it might make in protective conditions: it specifically retained jurisdiction only over protective conditions and released the merger approval from its control. The merged company will thus become one of the "given" factors in any future re-evaluation of a competitor's need for protection in the context of the larger public interest.

This argument also overestimates the matter that might be in doubt. Inherent diversions are unaffected by the D.T. & I. limitation. Post-D.T. & I. diversions, if they occur, can be corrected without the slightest reduction in the benefits that the Commission found to justify the merger. For instance, if the Commission found that $10 million in post-D.T. & I. diversions will occur from Katy to the merged BN-Frisco each year, even a complete indemnification of Katy for the full $10 million of added diversions, the most far-reaching protective condition that the Commission could impose, would leave all of the other merger benefits relied upon by the ICC completely intact. The $10 million that the BN-Frisco would be required to return to Katy would leave intact the $33 million in new revenues that the BN-Frisco had gained from inherent diversions and other merger benefits.

protective conditions or of the standard D.T. & I. conditions after the second year.[33] Of course, the Commission's evaluation of competing carriers is supported by substantial and reliable evidence through the second year, when D.T. & I. conditions will still be in effect. But the picture may change greatly in the third year. That is a problem only because the Commission's opinion frequently cites figures and projections for the third year that are completely unreliable if substantial post-D.T. & I. diversions occur in that year.[34]

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33. As this sentence makes clear, part of the difficulty in discussing the Commission's D.T. & I. limitation is the circularity of the issue itself: did the Commission's decision not to impose protective conditions undermine the substantial evidence it needed to decide whether to impose protective conditions?

34. It is totally within the Commission's expert judgment to choose the period of time that is relevant to evaluate a merger's future effect on the public interest. The Commission's rules for evidence and exhibits submitted in merger proceedings require that all projections cover the first three post-

Whether these diversions do occur, however, is a matter that is entirely subject to future decisions of the Commission and the parties to this action. First of all, the Commission specifically retained jurisdiction over the conditions for two years. 360 I.C.C. at 1179-80. As all of the parties gain experience with the actual impact of the merger, any of them can submit a proposal to the Commission to extend the D.T. & I. conditions into a third year or longer, if the actual facts justify

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merger years. 49 C.F.R. §§ 1111.1-2. The BN-Frisco opinion also cites and relies upon many projections that extend into the third year. Of course, these indications that the Commission looked at third year figures that were based on certain assumptions did not automatically prohibit the Commission from altering any of those assumed conditions. That would be far too rigid a straightjacket to impose on administrative procedures. Likewise the Commission could change the relevant focus to a two-year period and explain its choice. That is essentially what the Commission did here--the issue is complicated only because the Commission did not fully and directly explain the change in focus.

such protection.[35] Second, the Commission's new view that the Interstate Commerce Act prohibits most of the unfair practices previously controlled through D.T. & I. conditions[36] means that any carrier may, in effect, extend the D.T. & I. conditions by

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35. In prior merger approvals, the Commission had always retained jurisdiction over D.T. & I. conditions indefinitely, so that any party could petition to amend or remove the conditions. In light of this practice, the Commission's limitation of D.T. & I. conditions to two years, with the retention of jurisdiction, really amounts to little more than a procedural decision to reverse the burden of proof. Prior decisions had assumed D.T. & I. conditions remained justified unless a protesting party objected and proved otherwise. The Commission now assumes that, after two years, they will not be justified unless a protesting party objects and proves otherwise.

36. See note 31 and accompanying text.

An example of the Act's duplication of D.T. & I. conditions is that 49 U.S.C. § 10705(d) currently gives Katy the power to challenge any future cancellation by BN-Frisco of a through route or joint rate and to force BN-Frisco to prove before the Commission that such cancellation is consistent with the public interest. That one section alone gives Katy substantial safeguards against post-D.T. & I. diversions.

protesting any discriminatory practices to the Commission. Third, as the Commission noted, 360 I.C.C. at 957, during the first two post-merger years the affected carriers will be able to make significant adjustments to the new competition. Katy and Soo have a strong incentive to meet the challenge of the more efficient BN-Frisco, and their response may greatly reduce or eliminate the post-D.T. & I. diversions that might occur if the two contingencies discussed above do not prevent those diversions in the first place.

Furthermore, the Commission's projection of carrier economic conditions three years into the future is a kind of agency function that the Supreme Court has recognized to be primarily a question of probabilities, and thus peculiarly subject to the expert experience, discretion, and judgment of the Commission. In making a predictive judgment, the expertise of the Commission

supplements, and may supplant, the projections placed in the record by the parties. FCC v. National Citizens Commission for Broadcasting, 436 U.S. 775, 814, 98 S. Ct. 2096, 2122, 56 L.Ed.2d 697 (1978); United States v. ICC, 396 U.S. 491, 516, 90 S. Ct. 708, 720, 24 L.Ed.2d 700 (1970); FPC v. Transcontinental Gas Pipe Line Corp., 365 U.S. 1, 28-29, 81 S. Ct. 435, 450, 5 L.Ed.2d 377 (1961); United States v. Detroit & Cleveland Navigation Co., 326 U.S. 236, 240-41, 66 S. Ct. 75, 77, 90 L.Ed. 38 (1945). To hold otherwise would paralyze agencies merely because the future is not subject to proof. While an agency cannot make a projection that is without any reasonable basis, the role of substantial evidence is greatly diminished. The unique context of this decision, particularly the fact that the Commission remains completely in control of whether any post-D.T. & I. diversions actually occur, gives the

Commission a reasonable basis to project Katy's and Soo's economic future and need for protective conditions throughout the three-year period under examination.37

Because the evidence before the Commission was 95% complete and reliable, through the second post-merger year, and especially because the third-year impact is entirely subject to the future actions of the parties and the continuing jurisdiction of the Commission, we do not find that the two-year limitation undermined the Commission's ability to project the need of

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37. We are especially inclined to allow the Commission leeway in these future projections because it is clearly developing an entirely new set of policies regarding D.T. & I. conditions. In fact, the Commission has announced a rulemaking proceeding that might eliminate all past D.T. & I. conditions and establish a rule for their future use. 45 F.R. 46461 (July 10, 1980). The BN-Frisco opinion acknowledged the probability of such a proceeding and that the two year limit on D.T. & I. conditions is part of the Commission's re-evaluation process. 360 I.C.C. at 957.

competing carriers for protective conditions.38

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38. We acknowledge that the Commission's explanation of its decision leaves much to be desired. When the Commission's own rules and the bulk of its opinion had indicated that the third year was of some significance, the Commission should have explained the two year limitation more thoroughly. The only specific explanation offered was:

> We believe this will give affected carriers significant time to adjust to the new competitive climate. Although we understand that the routing practices between the railroads are of longstanding [sic], that does not require that it take a long time to change them. We are currently reevaluating our imposition of traffic protective conditions and will issue a policy statement on the matter shortly which may modify these conditions, but only after careful consideration.

360 I.C.C. at 957.

We do not mean to condone or encourage such abbreviated explanations of agency action. Nevertheless, we may uphold "a decision of less than ideal clarity if the agency's path may reasonably be discerned." Bowman Transportation v. Arkansas-Best Freight System, Inc., 419 U.S. 281, 285-86, 95 S. Ct. 438,442, 42 L.Ed.2d 447 (1974). With the aid of our strongest bifocals, we can trace the Commission's footsteps here, in

### 3. The Denial of Special Protective Conditions

Both Katy and Soo asked the Commission to impose extensive special protective conditions, in addition to the standard D.T. & I. conditions, to protect them from various detrimental effects of the merger. Katy requested, among other conditions, complete indemnification for 20 years against all traffic lost to the merged BN-Frisco, regardless of the reason for the diversion and regardless of Katy's other income. Soo requested a variety of conditions[39] that not only would insulate it from economic loss, but would actually improve its long-term financial position by more than $8 million.

The Commission denied these requests for special protective conditions and indemnification. Katy argues on appeal that

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the light of the opinion as a whole.

39. See note 10 above.

the decision of the Commission to deny indemnification and special protective conditions was based upon projections of Katy's ability to survive the losses, both of which were not supported by adequate findings or substantial evidence. Specifically, Katy says that (1) the Commission made no specific findings as to the net revenue effect from the three sources of Katy's new positive financial standing as identified by the Commission and (2) it was improper for the Commission to consider these three sources of financial stability because they are "speculative".

Katy's first point of error is without merit because, as discussed under VI.2. above, an agency is not required to make specific findings in the course of making future projections. National Citizens Commission, 436 U.S. at 814, 98 S. Ct. at 2122; United States v. ICC, 396 U.S. at 516, 90 S. Ct. at 720; Transcontinental Gas Pipe,

365 U.S. at 28-29, 66 S. Ct. at 77. This reasoning even allows an agency to speculate about the future to some degree, based on available facts. McLean Trucking, 321 U.S. at 89, 64 S. Ct. at 381. Thus Katy's second point of error is also without merit, even if we accepted Katy's characterization of the Commission's projection as "speculative."

But a review of the record shows that the Commission cited very reliable evidence as the basis of its projection that Katy can withstand these diversions without a loss of essential service. The Commission fully acknowledged Katy's bleak financial history, but the relevant decision was concerned with Katy's future, and in that context the Commission gave greater weight to three new sources of financial stability for Katy. 360 I.C.C. at 954-55, 1118-22. First, the Commission found that Katy can expect strong growth in revenues because of coal

transportation for several new electric generating plants. Three of the units were completed as of the time of the Commission's opinion, and Katy itself projected $26 million annually in new revenues from these plants alone. Five additional units were and are projected, each generating $10 million in additional gross revenues for Katy. These findings alone would support the Commission's view that Katy can withstand the merger, because the maximum gross revenue loss for Katy due to the merger is projected to be about $9 million. 360 I.C.C. at 1091. Second, the Commission found that Katy will experience substantially reduced maintenance costs because of the imminent completion of a major track rehabilitation program. Again, the testimony of Katy's own witnesses largely supported the Commission's evaluation of the program. Katy cannot argue with the Commission's choice to believe them. Third,

the Commission recognized that Katy had concluded an agreement with its parent company to be reimbursed for any Katy tax losses that could be utilized by the parent company. The agreement is an undisputed fact, and demonstrably provides Katy with a significant "cushion" against losses. It was not an improper consideration in evaluating Katy's overall financial stability. Taken together, these three factors offer substantial support for the Commission's projection of Katy's future.[40] If the first two post-merger years prove the Commission to have been wrong, Katy has a complete

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40. We note that Katy reported most of these same projections in glowing terms to its own shareholders in the company's 1977 annual report, which was part of the record before the Commission. Furthermore, Katy's briefs and oral argument on this point were little more than requests that we re-weigh the evidence, a task that has long been recognized to be beyond the competence of a reviewing court.

remedy in petitioning the Commission to amend the conditions imposed on the merger.

Soo argues on appeal that the Commission's projections of its losses due to the merger were not supported by substantial evidence and that, therefore, the decision to deny Soo's requested protective conditions must be remanded. We reject this argument because the Commission made a specific finding that Soo could easily withstand even the larger diversions and losses that Soo itself projected. 360 I.C.C. at 953. Soo does not challenge that finding, so the exact amount of Soo's projected losses is immaterial for the purposes of this review. The Commission's ultimate conclusion, that Soo did not need protection, is not affected even if Soo's projections are more accurate than the Commission's.

**4. The Commission's New Policies Regarding Indemnification**

The Commission also announced in its decision two new policies: (1) indemnification of a competitor railroad for traffic losses due to a merger will no longer be viewed as a viable protective condition "under any circumstances," and (2) the Commission will no longer impose any protective condition not sought by a protesting railroad. 360 I.C.C. at 953. In sections VI.2. and 3. above, we rejected Katy's argument that there was no substantial evidence to support the finding that Katy did not need special protective conditions, including indemnification. Katy now asserts as an independent ground of error that these two new policies as applied to Katy were arbitrary, capricious, and a violation of procedural due process because they were adopted "without warning."

It is true that the Commission's new policies regarding indemnification and "unrequested conditions" were not announced until the BN-Frisco opinion. But even if both of these policies were applied to Katy in this opinion, a matter itself very much in question,[41] that would not provide the slightest ground of error. An agency may change its policies in the course of a specific adjudication, American Trucking, 387 U.S. at 416, 87 S. Ct. at 1618, and even apply those policies for the first time to the parties involved, NLRB v. Bell Aerospace Co., 416 U.S. 267, 292-94, 94 S. Ct. 1757, 1770-71, 40 L.Ed.2d 134 (1974); SEC v. Chenery Corp., 332 U.S. 194, 202-04, 67 S. Ct. 1575, 1580-81, 91 L.Ed. 1995 (1947). The only restriction upon an agency's discretion to develop policy in this manner

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41. See the final paragraph of this section.

is that the agency must adequately explain its departure from the previous policy. Atchison, T. & S. F. Ry., 412 U.S. at 807-08, 93 S. Ct. at 2374-75 (1973).

The Commission's duty to explain its change in policy regarding indemnification was adequately fulfilled in the BN-Frisco opinion itself.[42] We find that explanation

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42. The explanation was given as follows:

> The Commission has imposed indemnity conditions when it was concerned about preserving existing service for the public and when it appeared that alternate protective conditions would not accomplish this result.
>
> Our imposition of indemnification in the past has been to allow a carrier to continue to provide service while a more permanent solution was being finalized. We no longer require that corporate entities be preserved; rather, we are concerned about essential services. In this climate a provision of indemnity seems highly anticompetitive. Indemnity may well induce a carrier to become less aggressive and provide less than optimum service. Indemnity also may be viewed as a reward for

entirely satisfactory, which completes our inquiry regarding the new indemnification policy.

The Commission's explanation of its "unrequested conditions" policy is given in the context of a discussion of the Commission's new restricted use of protective conditions. The "policy" is announced less as an independent principle than as a means of ensuring that conditions are not imposed unless substantially justified:

> We do not believe that a merger should be conditioned unless essential services have been shown to be affected .... Hence, a condition would not be imposed which drains the benefits of a proposed merger

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> being unable to compete in the marketplace. This transfer of funds would, in effect, be a massive cross-subsidization not only of commodities, but of inefficient operation of another railroad, merely to preserve the existence of the other railroad. Hence, we do not see indemnity as a viable condition under any circumstances.

360 I.C.C. at 952-53.

> unless it benefits shippers, is operationally feasible, is related to the competition that will ensure [sic] from the merger, is sought by the protestant ..., and would not jeopardize the future of the merged company by depriving it of major benefits of the merger. [emphasis added]

360 I.C.C. at 951-52. A more thorough analysis would be helpful. But in the context of the Commission's larger policy decision restricting the use of protective conditions, the "unrequested conditions" policy is adequately explained as a means of implementing the larger policy. The Commission is merely announcing that it will no longer take the initiative in suggesting protective conditions. It is reasonable to assume that a carrier will request those conditions that are actually needed in a merger, and that the Commission's former policy of initiating protection often led to unnecessary restrictions. The explanation might have been more complete, but we will "uphold a decision of less than ideal clarity if the

agency's path may reasonably be discerned." Bowman Transportation, Inc. v. Arkansas-Best Freight System, Inc., 419 U.S. 281, 285-86, 95 S. Ct. 438, 442, 42 L.Ed.2d 447 (1974). That standard has been met here, once the "policy" is viewed in its proper context.

Katy further argues that, even if these two new policies are otherwise proper, their joint application for the first time to Katy is a denial of due process because Katy relied on receiving indemnification, so requested no other special protective conditions and is now foreclosed from requesting any additional protection. This argument is undercut from all sides. In the first place, there is no indication in the opinion itself that the Commission reached any decision through applying the new policies to Katy. The Commission consistently states that Katy failed to establish the need for any protective condition at all, a decision on the merits that does not involve either

policy. Second, if Katy relied upon receiving indemnification, that reliance was grossly misplaced. The Commission has imposed indemnification only twice in its history. Penn Central Merger Case, 322 I.C.C. at 529, 532 (1966); Chicago & Northwestern Railway-Control-Chicago Rock Island and Pacific Railroad, 347 I.C.C. 556, 616, 627, 630, 631 (1974). And even if it were not misplaced, such reliance cannot stand in the way of an agency's new policy determinations, at least absent "substantial" adverse consequences. Bell Aerospace, 416 U.S. at 295, 94 S. Ct. at 1772. Assuming arguendo that the Commission applied the policies to Katy, we cannot say that Katy has suffered "substantial" adverse consequences when it can petition the Commission to amend the conditions should the future show that the Commission's judgment was wrong. We therefore find no

basis to remand the Commission's decision on these grounds.

5. The Anticompetitive Effects of the Merger

The Commission found that the merger "will not adversely diminish competition" and would, in fact, stimulate overall competition. Although the Commission used the Department of Justice study that came to the same basic conclusion, the opinion indicates that the Commission also relied upon its own studies, data, and conclusions. 360 I.C.C. at 941. The Illinois parties charge that this analysis was defective, but the only substantial grounds they advance are that the Commission did not make specific findings about the tendency of the BN-Frisco merger to encourage other mergers in the future. This argument is, once again, based on a misunderstanding of the need for

specific findings in the context of an agency's projections of the future. National Citizens Commission, 436 U.S. at 814, 98 S. Ct. at 2122; United States v. I. C. C., 396 U.S. at 516, 90 S. Ct. at 720; Transcontinental Gas Pipe, 365 U.S. at 28-29, 66 S. Ct. at 77. In addition, the Commission noted that

> [a] domino type effect from a merger of this sort is not necessarily contrary to the public interest. Indeed, where rail carriers are forced to look to rationalization, operating efficiencies, elimination of redundant facilities, and improved service through some form of consolidation or restructuring to continue essential services, the public interest can only benefit.

360 I.C.C. at 930. Any future mergers will be evaluated on their own merits to determine whether they are consistent with the public interest. Consequently, no other findings about future mergers were necessary in the BN-Frisco opinion.

### 6. Employee Protection

The operating efficiencies created by railroad mergers often result in a loss of positions for current employees. Section 11347 of the Interstate Commerce Act[43] therefore requires the Commission "to provide a fair arrangement ... protective of the interest of employees who are affected by the transaction...." The second sentence of this provision allows "the rail carrier

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43. The current text of § 11347 reads, in relevant part, as follows:

> When a rail carrier is involved in a transaction for which approval is sought under sections 11344 and 11345 or section 11346 of this title, the Interstate Commerce Commission shall require the carrier to provide a fair arrangement at least as protective of the interest of employees who are affected by the transaction as the terms imposed under this section before February 5, 1976, and the terms established under section 565 of title 45. Notwithstanding this subtitle, the arrangement may be made by the rail carrier and the authorized representative of its employees.

and the authorized representative of its employees" to negotiate their own protective arrangement, obviating the need for the Commission to impose employee protection.

The final issue in this appeal is whether that requirement is intended to cover employees of any carrier, or only employees of the merging railroads. The RLEA has urged the broader interpretation upon the Commission and reviewing courts since 1946, largely without success. The Commission has consistently held that § 11347 covers only employees of merging carriers,[44] and has been upheld twice by

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44. New York Dock Ry.-Control-Brooklyn Eastern Dist., 354 I.C.C. 399 (1978), 360 I.C.C. 60 (1979); Great Northern Pac.-Merger-Great Northern, 331 I.C.C. 228 (1967); Pennsylvania R.R.-Merger-New York Central R.R., 328 I.C.C. 304, 343-344 (1968); Texas & Pacific Ry.-Control-Kansas O. & G. Ry., 321 I.C.C. 309, 339 (1964); Seaboard Air Line R.R.-Merger-Atlantic Coast Line, 320 I.C.C. 122, 203-204 (1963), aff'd Florida East Coast Ry. v. United States, 259 F. Supp. 993, 1019 (M.D. Fla. 1966), dismissed as moot sub nom. R. L. E. A. v.

reviewing courts.[45] The RLEA position has been clearly affirmed by a reviewing court only once.[46]

United States, 386 U.S. 544, 87 S. Ct. 1299, 18 L.Ed.2d 285 (1967); Chesapeake & O. Ry.-Control-Baltimore & O. R.R., 317 I.C.C. 261 (1962); Southern Ry.-control-Central of Georgia Ry., 317 I.C.C. 557, 567-8 (1962), aff'd, R. L. E. A. v. United States, 226 F.Supp. 521 (E.D. Va. 1964); Baltimore & Ohio R.R. Operation, 261 I.C.C. 615, 619-20 (1946).

45. Florida East Coast Ry. v. United States, 259 F.Supp. 993, 1019 (M.D.Fla. 1966) (affirming Seaboard Air Line Railroad), dismissed as moot sub nom. R. L. E. A. v. United States, 386 U.S. 544, 87 S. Ct. 1299, 18 L.Ed.2d 285 (1967); R. L. E. A. v. United States, 226 F.Supp. 521, 525 (E.D. Va. 1964).

46. Soo Line R.R. v United States, 280 F.Supp. 907 (D.Minn. 1968). The RLEA also cites R. L. E. A. v. United States, 216 F.Supp. 101 (E.D. Va. 1963), as authority for its position. We interpret that case to be based on the unique factual situation that the employees of the nonmerging railroad found to be covered under § 11347 were in effect employees of the merging railroad. A later decision by the same court refused to follow the broader interpretation of Soo Line urged upon us by the RLEA and upheld the ICC position. R. L. E. A. v. United States, 226 F.Supp. 521, 525 (E.D. Va. 1964).

In the BN-Frisco opinion, the Commission considered the effect of the merger on all carrier employees as part of its broad view of the public interest under § 11344(c). But only the employees of BN and Frisco were granted actual protection in the Commission's order. 360 I.C.C. at 946-48. The Commission thoroughly discussed the RLEA position, but rejected it based on a view of the statute as a whole, its legislative history, and its interpretative history.

The Commission first noted that, although the first sentence of § 11347 seems to require protection for <u>any</u> carrier employee affected by the merger, the second sentence provides, in an undifferentiated transition, that "the arrangement may be made by the rail carrier and the authorized representative of its employees." It is difficult to imagine that when Congress wrote this sentence it was contemplating that a non-merging carrier would agree to

protect its own employees from the merger of two competing carriers. Because the second sentence obviously applies only to the merging carrier, the Commission reasons that Congress intended that same meaning in the preceding sentence.

The Commission finds this interpretation fortified by the statute's legislative history. Section 11347 is descended directly from the Washington Job Protection Agreement of 1936 (WJPA), which served as the model for § 5(2)(f), later recodified as § 11347, when it was first enacted as part of the Transportation Act of 1940. Brotherhood of Maintenance of Way Employees v. United States, 366 U.S. 169, 173-74, 81 S. Ct. 913, 915, 6 L.Ed.2d 206 (1961); United States v. Lowden, 308 U.S. 225, 237-38, 60 S. Ct. 248, 254-55, 84 L.Ed. 208 (1939).[47] The WJPA limited its job

47. See, also, New York Dock Ry. v. United

protection to employees of the merging carriers.[48] The Commission reasoned that this legislative history indicates Congress did not intend § 11347 to require a more liberal scope of job protection.

Finally, the Supreme Court has stated that a reviewing court may "accord great weight to the longstanding interpretation placed on a statute by an agency charged with its administration. This is especially

States, 609 F.2d 83, 86 (2d Cir. 1979); testimony of George M. Harrison before the House Committee on Interstate and Foreign Commerce, H.R. 2531, 76th Congress, 1st Sess. 213, 216-17, 241, 243 (1939), and before the Senate Committee on Interstate Commerce, S. 1310, 2016, 1869, and 2009, 76th Cong., 1st Sess. 34 (1939).

48. For example, § 4 of the WJPA, quoted by the Commission, 360 I.C.C. at 949, n.81, reads: "Each carrier contemplating a coordination shall give at least ninety (90) days written notice to bulletin boards convenient to the interested employees of each such carrier and by sending registered mail notice to the representative of such interested employees." Other sections of the WJPA also define the operation of the agreement in terms of the employees of the applicant carriers. See, e. g., §§6(a), 7(a), 10(a), and 11(a).

so where Congress has re-enacted the statute without pertinent change." Bell Aerospace, 416 U.S. at 275, 94 S. Ct. at 1762. Congress re-enacted and amended § 5(2)(f) in the 1976 4R Act, adding a requirement that an employee protection agreement under that section "shall contain provisions no less protective of the interests of employees than those heretofore imposed pursuant to this subdivision ...." 49 U.S.C. § 5(2)(f).[49] The Act, including § 5(2)(f), was further amended and recodified into 49 U.S.C. § 11347 in 1978. Revised Interstate Commerce Act, Pub.L. No. 95-473, 92 Stat. 1337. That act clarified the language of the 1976 amendment and again affirmed the Commission's use of employee protection prior to 1976. Because the Commission's view of its authority under § 5(2)(f) was

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49. The relevant text of § 11347, the successor of § 5(2)(f), is given in full at note 43 above.

well-established in 1976 and 1978, this double affirmation by Congress, in the absence of any other support for the RLEA position,[50] puts the question to rest. We affirm the Commission's view that § 11347 requires protection only for employees of the merging carriers.

The RLEA asserts as an independent error that § 11344(b)(4) requires the Commission to consider the "interest of carrier employees affected by the proposed transaction" as an element of the public interest before it decides that a merger is "consistent with the public interest." Based on certain language in the opinion,[51] the RLEA claims that

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50. The one district court case cited by the RLEA in support of its position, Soo Line, 260 F.Supp. at 907, did not consider the second sentence of § 11347 and was decided before Congress amended and recodified § 5(2)(f) in 1976 and 1978.

51. The RLEA bases its contention on the following language, used by the Commission to introduce its discussion of employee protection after having announced its approval of the merger: "Since we have decided to

the Commission violated this statute by considering the interest of employees only after deciding to approve the merger.

We reject this contention. Section 11344 is not intended to dictate a procedural order for the Commission's considerations. The statute says, "[in] a proceeding under this section, the Commission shall consider at least the following ...." That language clearly sets forth a list of considerations, and does not dictate a procedure. The Commission has fulfilled the requirement of § 11344(b)(4) if it considers employee interests during the course of its proceeding. The Commission carefully considered the interests of all employees in this case. During the course of its investigation, the Commission sent out detailed questionnaires

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approve the merger, we must consider the interest of, and provide protection for, carrier employees." 360 I.C.C. at 946.

to the fourteen carriers whose employees might be affected by the merger. Ten of these responded that their employees would not be adversely affected. Two of the remaining four carriers are now in the course of liquidation or restructuring. Of the remaining two carriers, Katy claimed a possible impact on 37 employees and admitted that even this figure would be "mitigated by attrition." 360 I.C.C. at 872. Illinois Central Gulf Railway said that adverse impacts on employees could not be "precisely defined" because any loss of jobs could be the result of "numerous variables besides the proposed merger." Id. at 881. We find that this investigation and the Commission's thorough discussion of the effect of the merger on employees[52] fulfilled all of the statutory requirements.

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52. See, e. g., 360 I.C.C. at 872, 881, 897.

## VII. Conclusion

The merged BN-Frisco will indeed present formidable new competition to the railroads in its service areas, and will change familiar shipping practices relied upon by trade organizations and businesses throughout the United States. The Commission has determined that this competition and change will reverberate beneficially throughout the rail transportation industry, and the strength of that ultimate conclusion is demonstrated by the fact that no petitioner before us could directly challenge it. We acknowledge that the Commission often failed to explain its reasoning and choices with the degree of clarity and thoroughness that we would wish. The transportation industry and the government agencies responsible for its regulation, however, are undergoing a period of profound and far-reaching change. The resulting discomposure certainly does not excuse any agency from the obligation to

explain its actions. But when lapses in clarity are due to uncertainty about the future course of policy or a desire to preserve options, it is appropriate for a reviewing court to uphold the agency's choices, provided that the agency's path can "reasonably be discerned." Bowman Transportation, 419 U.S. at 286, 95 S. Ct. at 442. We find that to be the case here. The stay of the order of the Interstate Commerce Commission is vacated; the decision of the Commission is AFFIRMED.

THE REPORT AND ORDER OF THE INTERSTATE COMMERCE COMMISSION (A 86 - A 485) IS CONTAINED IN A SEPARATE BOUND VOLUME.